1470

Publication 1470 (3-89)

Package for the Special Enrollment Examination

Includes:

SEE Background Material
Rules For Tax Return Preparers
Questions and Answers Sample Booklet
Study Material Request Form
Application and Instruction Form

Department of theTreasury
Internal Revenue Service

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Special Enrollment
Examination

Purpose of Enrollment

Purpose of Enrollment

Enrollment procedures are designed to assure the technical competence and ethical appreciation of persons, other than attorneys and certified public accountants, who practice before the Internal Revenue Service. Practice before the Internal Revenue Service, as defined in Treasury Department Circular No. 230, includes all matters connected with presentations to the Service relating to a client's rights, privileges, and liabilities under laws or regulations administered by the Service. Such presentations include the preparation and filing of documents, all communications with the Service, and the representation of a client at conferences, hearings, and meetings.

Eligibility for Enrollment

Circular 230 contains the rules of practice before the Service and authorizes the Director of Practice to grant enrollment to any applicant:

1. Who is not an attorney or certified public accountant; (Attorneys and certified public accountants are eligible to practice without enrollment.)
2. Whose conduct would not justify suspension or disbarment under provisions of Circular 230;
3. Who is technically competent in tax matters. This must be demonstrated by a written examination (Special Enrollment Examination) unless the applicant is a former Service employee who, through past service and technical experience, meets the requirements of Section 10.4(b), Circular 230.

Special Enrollment Examination

The written examination covers Federal taxation and tax accounting and the use of tax return forms for individuals, partnerships, corporations, trusts, estates and gifts. It also covers ethical considerations and procedural requirements in Circular 230, and Conference and Practice Requirements, 25 C.F.R. 601.501. It consists of four parts which will take two days to complete. Parts I and II are given on the morning and afternoon of the first day and Parts III and IV on the morning and afternoon of the second day.

The questions in the 1988 examination are directed toward the tasks which enrolled agents must perform to complete and file forms and tax returns, and to represent taxpayers before the Internal Revenue Service. The examination will include true or false, multiple choice and problem type questions and will cover the following tax areas:

Part I	Individuals
Part II	Sole Proprietorships and Partnerships
Part III	Corporations (including S Corporations), Fiduciaries, and Estate and Gift Tax
Part IV	Ethics, Recordkeeping Procedures, Appeal Procedures, Exempt Organizations, Retirement Plans, Practitioner Penalty Provisions, and Research Materials

Qualifications for Examination

Although no particular experience or educational requirements are specified, examination candidates should be able to answer income tax accounting questions on the intermediate college course level. When taking the examination, a candidate must meet all requirements for enrollment.

Preparation for Examination

All questions in the 1989 examination will refer to the Internal Revenue Code as amended through December 31, 1988. Questions will relate to tax year 1988. The following Internal Revenue Service publications provide much of the basic information to assist you in preparing for the examination.

Publication 17	Your Federal Income Tax
Publication 216	Conference and Practice Requirements
Publication 334	Tax Guide for Small Business
Publication 541	Tax Information on Partnerships
Publication 542	Tax Information on Corporations
Publication 553	Highlights of 1988 Tax Changes
Publication 560	Self-Employed Retirement Plans
Publication 589	Tax Information on S Corporations
Publication 590	Individual Retirement Arrangements

The explanations and examples in the above publications reflect the interpretation by the Internal Revenue Service of tax laws enacted by Congress, Treasury Regulations, and court decisions. They are not the official source for the answers to the examination questions. In your preparation you should familiarize yourself with the Internal Revenue Code and Regulations.

You may order all of the above publications, plus others that will be of value to you, free of charge by completing Form 4190A, Special Enrollment Examination (SEE) Study Material Request and Mailing Label, and mailing it to the address listed on the form.

Application for Special Enrollment Examination Form 2587

Form 2587, Application for Special Enrollment Examination, and instructions are included in the application packet.

Grading Examinations and Notifying Candidates

District Directors will send the completed examination answer sheets to the Office of Director of Practice, HR:DP, for grading. After the passing grade is determined for each of the four parts, the scores on the answer sheets are compared to the passing grade.

Candidates will receive formal notification of their examination results on or about December 31, 1989. The grading of the answer sheets and the formal notification of the examination results are computer processed.

Application for Enrollment to Practice Before the Internal Revenue Service — Form 23

Successful candidates will receive forms and instructions for applying for enrollment with their examination results. *Eligibility to apply for enrollment continues for 1 year from the date of the notification letter.*

Within 1 year from the date of notification letter, eligible persons who wish to be enrolled to practice before the Service must complete and submit the application, Form 23, with a $25 application fee, in accordance with instructions on the form. All questions on the application must be completely answered. Each application is investigated to determine whether the statements made are correct and whether facts or circumstances exist which reflect unfavorably on the candidate. This procedure takes from 4 to 6 months. An incomplete application will take longer to process.

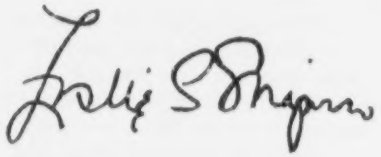
If the investigation raises a question about an applicant's eligibility for enrollment, the applicant will be informed, permitted to submit additional information, and given an opportunity to be heard. Each applicant whose investigation is satisfactory will be enrolled to practice before the Internal Revenue Service, and an enrollment card will be issued.

Continuing Professional Education Requirements for Enrolled Agents

All individuals enrolled to practice before the Internal Revenue Service are required to renew their enrollment on a periodic basis. A condition of eligibility for renewal of enrollment is the satisfaction of continuing professional education requirements. Applications for renewal of enrollment for those individuals enrolled after January 31, 1990, will be required to be filed between November 1, 1992 and January 31, 1993 and between November 1 and January 31, of every third year subsequent thereto. A minimum of 72 hours of qualifying continuing education credit must be completed between February 1, 1990 and January 31, 1993 and during each three year period subsequent thereto. A minimum of 16 hours of qualifying continuing education credit must be completed each year February 1 - January 31. An individual who receives initial enrollment during an enrollment cycle must complete two hours of qualifying continuing education credit for each month enrolled during such enrollment cycle. Enrollment for any part of a month is considered enrollment for the entire month. An individual who fails to comply with the renewal of enrollment requirements will be placed on a roster of inactive enrolled individuals for a period of three years. During this time the individual will be ineligible to practice before the Internal Revenue Service.

Inquiries and Application Forms

District Internal Revenue Service offices can supply the Special Enrollment Examination Application Packet and answer most questions about enrollment and the Special Enrollment Examination. Further inquiries should be addressed to the Office of the Director of Practice, HR:DP, Internal Revenue Service, Room 1416 ARFB, 1111 Constitution Avenue, NW, Washington, DC 20224.



Director of Practice

Special Enrollment
Examination

Background Material for Applicants

This publication covers some basic information on federal income tax. It includes brief discussions on:

- History of federal income tax,
- Treasury regulations,
- Revenue rulings and revenue procedures,
- Bulletin index-digest system,
- Courts, and
- Researching

History of Federal Income Tax

Modern Federal income tax history began with the enactment by Congress of the Revenue Act of 1913, which followed the 16th Amendment to the Constitution giving Congress the power to tax incomes without apportioning the tax among the states according to their populations.

Between 1913 and 1939 Congress passed fourteen revenue acts. During that time whenever it was necessary to change the law, a new law was substituted for the old with much of it taken from the old. To circumvent this cumbersome method, Congress adopted the Internal Revenue Code of 1939 so that it could be changed by amendment.

Between 1939 and 1953 the Internal Revenue Code of 1939 was amended twenty-one times. Then in 1954 the present Code, the Internal Revenue Code of 1954, was adopted primarily to establish a more logical arrangement and to eliminate some inequities in the law.

Internal Revenue Code of 1986

The Tax Reform Act of 1986 (Public Law 99-514), which was signed on October 22, 1986, redesignated the Internal Revenue Code of 1954 as the Internal Revenue Code of 1986.

Legislative Process

The Constitution provides that all Federal income tax legislation will originate in the U.S. House of Representatives. Hearings are first held by its Committee on Ways and Means to consider many viewpoints, including those of the President, the Secretary of the Treasury, and individual taxpayers. When a tax bill is introduced in the House, the complementary committee report is then published.

After debate and passage, the bill is sent to the Senate Finance Committee for consideration at its hearings. This committee prepares a report explaining changes and additions made to the House bill.

A conference committee later resolves any differences between the House and Senate versions of the bill and issues a report of its findings.

These committee reports are generally published in an Internal Revenue Service (IRS) publication, the *Cumulative Bulletin* (C.B.). This is a good source of information in interpreting Congressional intent behind amendments or new Code sections and contains background information on proposed Treasury regulations.

Significance of Code

The Internal Revenue Code is binding on all courts except when held to violate the Constitution. The judiciary gives great importance to the literal language of the Code, but this literal language does not answer every tax controversy. The courts also consider the history of a particular Code section, its relationship to other Code sections, the reports of Congressional committees, and Treasury regulations and IRS administrative policies.

Treasury Regulations

The regulations provide explanations, definitions, examples, and rules which explain the language of the Code. Your research of a particular Code section cannot be considered complete until you have read the regulations which interpret it.

Although IRS employees are bound by the regulations, the courts are not. The Supreme Court in 1936 said, ". . . The power of an administrative officer or board to administer a Federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the Statute. A regulation which does not do this . . . is a mere nullity . . ."[1]

Most income tax regulations are issued under the general authority of Code section 7805(a). These regulations are called interpretative regulations. But some other Code sections specifically authorize regulations to provide the details of the meaning and rules for that particular Code section. Regulations issued under this authority are called legislative regulations. The courts give great weight to regulations as indicated by what the Supreme Court said in 1936:

". . . Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissable but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement . . ."[2]

Classes of Regulations

The three classes of regulations are:

1. Temporary
2. Proposed
3. Final

All regulations are written by the Legislation and Regulations Division of the Office of the Chief Counsel, IRS, and approved by the Secretary of the Treasury.

Temporary regulations are issued to provide guidance for the public and IRS employees until final regulations are issued. Public hearings are not held on temporary regulations.

Proposed regulations are issued to solicit public written comments and public hearings are held if written requests are made. Proposed regulations do not replace the temporary regulations unless the proposed regulations specifically say they replace them.

The final regulations are issued after the public comments on the proposed regulations are evaluated, and they supersede the temporary regulations. The regulations are printed in the following sources:

- *Federal Register*
- Code of Federal Regulations (C.F.R.)
- Treasury Decisions (T.D.) in the Internal Revenue *Bulletin* (I.R.B.) and *Cumulative Bulletin* (C.B.)

Revenue Rulings and Revenue Procedures

Revenue rulings are the published conclusions of the IRS concerning the application of tax law to an entire set of facts.

Revenue procedures are official statements of procedures that either affect the rights or duties of taxpayers or other members of the public, or should be a matter of public knowledge.

The purpose of these rulings is to promote a uniform application of the tax laws, and therefore IRS employees must follow the rulings. While taxpayers can rely on the rulings, they can also appeal adverse return examination decisions based on those rulings to the Tax court or other Federal courts.

Revenue rulings and revenue procedures are published by IRS in the Internal Revenue *Bulletin* (I.R.B.), which is issued weekly to the public. The contents of the I.R.B. are consolidated at least semiannually into a permanent, indexed Cumulative Bulletin (C.B.). IRS publishes a Bulletin Index-Digest System, Publications 641, 642, 643, and 644, which is a research system that lists the rulings by subject and Code section and gives a brief explanation of the ruling.

Bulletin Index-Digest System

The Bulletin Index-Digest System provides a method for researching matters published since 1952 in the Internal Revenue *Bulletin*. It is divided into four services.

- Income Tax (Service One)
- Estate and Gift Taxes (Service Two)
- Employment Taxes (Service Three)
- Excise Taxes (Service Four)

Each Service consists of a basic volume and the latest cumulative supplement, issued quarterly for the income tax service and semiannually for the others.

The major portion of this Bulletin Index-Digest System consists of digests (brief summaries) of currently applicable revenue rulings and revenue procedures alphabetically arranged under topical headings and subheadings, along with digests of Supreme Court decisions, adverse Tax Court decisions on cases involving tax issues in which the Commissioner has announced acquiescence or nonacquiescence, Executive Orders, Treasury Department Orders, Delegation Orders, and other miscellaneous items published in the I.R.B. Each digest is preceded by descriptive "key words" that further identify the subject matter, followed by a citation to the Code and regulations section under which the item was published, and also a citation to the item and the I.R.B. or C.B. in which the full text of the item may be found. This arrangement of

digest under topical headings makes it possible to use the "subject matter" approach to find the revenue rulings or other items most specifically on point for a particular issue. Public laws, Treasury Decisions, and tax conventions are not digested, but are listed in a separate topical index.

The Bulletin Index-Digest System is designed primarily to help you find the Service position on any tax issue covered in material published in the Internal Revenue Bulletin. You will also find it useful for researching laws, regulations, and other matters published in the I.R.B.

Supreme Court Decisions

All Supreme Court decisions on Federal tax matters are published in the I.R.B. and C.B.

You can find Supreme Court decisions by using either the subject matter method or the Code section method. In addition, if you know the name of the case, you can also find the decision by turning to the finding list of Decisions of the Supreme Court. The decisions are listed in alphabetical order, followed by the Court Decision number and the digest number.

Tax Court Decisions

Tax Court decisions are not published in the I.R.B., but announcements concerning the Service's acquiescence or nonacquiescence in adverse Tax Court decisions (other than memorandum decisions) are published. Digests of adverse Tax Court decisions which the Service has announced acquiescence or nonacquiescence and which concern substantive issues are included under the appropriate subject matter headings. Each digest gives a summary of the facts and holdings, the applicable Code section, the Service position on acquiescence or nonacquiescence, a citation to the I.R.B. announcing the Service position, and a citation to the Tax Court volume in which the decision is published.

Under the applicable section number in the finding lists for Internal Revenue Code, the abbreviation "Acq." or "Nonacq." is followed by a citation to the Tax Court volume and to a digest.

If you want to verify the Service position on a particular adverse decision for which you know the name of the case, or if you want a citation for the decision, turn to the finding list of Decisions of the Tax Court. Decisions are listed in alphabetical order, followed by the Tax Court citation, "Acq." or "Nonacq.," and a digest number.

Currently Applicable Revenue Rulings and Revenue Procedures

The Listing of Revenue Rulings and Revenue Procedures includes the number of every revenue ruling and revenue procedure that has been published in the I.R.B. and has not been superseded, revoked, or declared obsolete. A citation to a digest follows each revenue ruling and revenue procedure number.

Actions on Previously Published Revenue Rulings and Revenue Procedures

The finding list of Actions on Previously Published Rulings and Revenue Procedures shows every revenue ruling and revenue procedure that has been modified, superseded, or otherwise acted upon, and gives the number of the later ruling or procedure, together with a citation to the appropriate I.R.B.

Cumulative Supplements

Cumulative supplements are issued quarterly for the income tax service and semiannually for the others. After you have researched the basic volume, you should check the cumulative supplement for later developments. Information on items published in the Bulletin after the cutoff date for the basic volume is presented in the same format used in the basic volume, that is, in finding lists, digests, etc.

Courts

Within the IRS the taxpayer may appeal an examination decision and request an Appeals Conference. If the taxpayer is not satisfied with the Appeals decision, he or she may appeal to the courts.

Tax Courts

A taxpayer may petition the United States Tax Court for a judicial determination of his or her tax liability within a specified period (generally 90 days) after receiving a notice of deficiency, but before he or she pays the tax. The Tax Court is a Washington, D.C. based tribunal of nineteen judges, including a chief judge. It is authorized by the Internal Revenue Code, but is entirely separate from the Internal Revenue Service. The Tax Court has jurisdiction over income, estate, and gift taxes, some excise taxes and certain declaratory judgments involving taxes. It does not have jurisdiction over employment, certain other excise, or wagering taxes.

Decisions of the Tax Court are issued as either a regular report or a memorandum decision. Regular reports are printed in bound volumes by the Government.

Memorandum decisions are not published by the Government. However, they are published commercially in bound volumes.

District Court and Claims Court

A taxpayer may choose to pay a disputed deficiency and then file a claim for refund. If the claim is denied by the Internal Revenue Service or if no decision is made in 6 months, the taxpayer may petition either the United States Claims Court or the United States District court. The Claims Court, located in Washington, D.C., is a tribunal of seven judges. There is at least one District Court in each state, and several in most. Cases before the District Court may be tried by jury.

The decisions of these two courts are published by three commercial printing houses.

- West Publishing Co., which publishes Federal Supplement (cited F. Supp.)
- Prentice-Hall, which publishes American Federal Tax Reports (cited A.F.T.R.)
- Commerce Clearing House, which publishes United States Tax Cases (cited U.S.T.C.)

Appellate Courts

Both the taxpayer and the Government may appeal decisions of the Tax Court or District Court to the Court of Appeals. There are thirteen Courts of Appeals divided into twelve circuits including the District of Columbia and one Court of Appeals for the Federal Circuit. All recent reports of the Courts of Appeals are published by West Publishing Company in the Federal Reporter, second series (cited F. 2d). Federal tax cases of the Courts of Appeals are also published by Prentice Hall (A.F.T.R.) and Commerce Clearing House (U.S.T.C.).

Supreme Court

Decisions of the Courts of Appeals and some decisions of other Federal courts may be reviewed by the United States Supreme Court. The Supreme Court is not obligated to hear all cases that it has been requested to review.

For Federal tax purposes, the most common type of case that the Supreme Court is required to hear is one in which a Federal tax statute is ruled to be invalid.

Petition to the Supreme Court to hear a case that is not subject to obligatory review is by writ of certiorari. The writ is initially requested by the appealing party and is issued by the Supreme Court to the lower appellate court, requesting the record of a case for review. The Supreme Court is said to have denied certiorari when it refuses to issue such a writ. The Court is free to do this as long as review is not obligatory.

The writ of certiorari has great significance. If the Court determines that various lower courts are deciding a tax issue in a contradictory manner, it may pronounce a decision and resolve the contradiction. Tax enforcement officials may be compelled to accept the contradiction until the Court finds a case suitable for review.

Significance of Decisions

Decisions of the courts other than the Supreme Court are binding on the Commissioner of Internal Revenue only for the particular taxpayer and for the years litigated. Thus, decisions of the lower courts do not require the IRS to alter its postion for all other taxpayers.

The Commissioner may decide to acquiesce to an adverse regular Tax Court decision. Decisions by the Commissioner on Tax Court decisions are published in the Internal Revenue *Bulletin* which later becomes part of the *Cumulative Bulletin*. Acquiescence (acq.) by the Commissioner generally means that the IRS will follow the Tax Court decision in cases involving similar facts. The Commissioner may also file nonacquiescence (nonacq.) which is notice that the Service does not accept an adverse decision and will not follow it in cases on the same issue. Generally, these cases are appealed to a higher court. An acquiescence or nonacquiescence may be subsequently revised by the Commissioner.

The Commissioner does not file either acquiescence or nonacquiescence to decisions other than those of the Tax Court.

Suggested Research Procedures

1. **Interview.** Interview the client and develop the facts.

2. **Internal Revenue Code.** Research the Internal Revenue Code to determine if it allows or denies the issue. The Code is the highest authority that you can cite and should be used in lieu of any other legal instrument.

3. **Treasury (Internal Revenue) regulations.** The regulations provide an in-depth probe of many issues, and often, examples of computations. If the Code or regulations do not address the issue specifically, go to Step 4.

4. **Revenue rulings.** Generally, the easiest method in researching for applicable rulings is through the Bulletin Index-Digest System. Rulings provide factual situations which may be "on point", that is, substantially identical in facts to an issue which you may be currently involved with. The Bulletin Index-Digest System also provides a list of cases which have been decided by the Tax Court to which the Commissioner has issued acquiescence or nonacquiescence. These cases are listed by Code section.

5. **Court cases.** Look to the courts for guidance in resolving the issue. It is at this point that your judgment becomes especially crucial. In researching a tax issue, obtain case citations within situations as close as possible to the issue in question. The commercial tax services provide synopses of court cases and allow you to find the applicable citations easily. In addition to the synopses, the tax services provide references to similar or related cases and for Tax Court cases, indicate whether the Commissioner has issued an acquiescence or nonacquiescence.

6. **New matters.** Almost all of the commercial tax services have a section entitled "New Matters" which provides information concerning recent developments.

7. **Court decisions.** Because the commercial tax services provide only a synopsis of court decisions, the particular facts of the issue may not be clear. Thus, you must pursue the matter to the casebook. Only in this way are you sure that the case is appropriate and similar to your own.

   A word of caution is necessary: Courts write their rulings using both decision and dictum.

   Decision is the court's formal answer to the principal issue in litigation. It has legal sanction and is enforceable by the authority of the court. Dictum is a court's statement of opinion on a legal point other than the principal issue in the case. Dictum does not have legal sanction and is not enforceable.

   Dictum and decision are often both addressed in a court's ruling and are not identified as such. Read the ruling carefully to determine where decision ends and dictum begins. Decisions are often prefaced by "we find" or "we hold", however, this is not a hard and fast rule.

8. Citator. Checking the citator, provided by commerical tax services, is a critical step in the research process. The citator contains case histories and recent case developments such as appeals, writs of certiorari, and related cases. The denial of a writ is not the equivalent of a reversal or disagreement. Its only significance is to show that the Supreme Court has refused to review the case.

The citator traces the case history from its original entry into Tax Court, District Court, or, Claims Court and, if the decision is appealed, continues through the Supreme Court.

Decisions reached in a lower court are sometimes reversed in the appellate or Supreme Courts. A lower court's decision which has been reversed on appeal has no legal sanction.

Courts also sometimes reverse themselves; this action may indicate a shift in legal opinion and will have precedential value. The term "precedence" means a legal decision that serves as an example, reason, or justification for a later decision. Precedence is a cornerstone of law. If a series of courts reverse a case in question, the case will quickly lose precedence.

Glossary

Interpretative Regulations—Treasury regulations issued under the general mandate of Code section 7805(a).

Legislative Regulations—Treasury regulations issued when a specific Code section authorizes the Secretary of the Treasury to write regulations giving details of the application of that Code section.

Regular Report—A report of a Tax Court decision thought to be of some value as a precedent.

Memorandum Decision—A report of a Tax Court decision thought to be of little value as a precedent because the issue has been decided many times.

Acquiescence—Notice given by the Commissioner of Internal Revenue of intent to follow, to the extent indicated in the Cumulative Bulletin, an adverse Tax Court decision.

Nonacquiescence—Notice given by the Commissioner of Internal Revenue of intent not to follow an adverse Tax Court decision.

Footnotes

[1]*Manhattan General Equipment Co. v Commissioner*, 297 U.S. 129; Ct.D. 1086, XV-1 C.B. 280; 36-1 U.S.T.C 9105, 17 A.F.T.R. 497 (1936).

[2]*Koshland v. Helvering*, 298 U.S. 441; Ct.D. 1124, XV-1 C.B. 219; 36-1 U.S.T.C. 9294, 17 A.F.T.R. 1213 (1936).

Special Enrollment
Examination

Rules for Tax Return Preparers

I.R.S. Regulations Relating to Tax Return Preparers

PART I—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

§ 1.6060-1 Reporting requirements for income tax return preparers.

(a) *In general.* (1) Each person who employs (or engages) one or more income tax return preparers to prepare any return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954, other than for the person, at any time during a return period shall satisfy the requirements of section 6060 of the Code by—

(i) Retaining a record of the name, taxpayer identification number, and principal place of work during the return period of each income tax return preparer employed (or engaged) by the person at any time during that period; and

(ii) Making that record available for inspection upon request by the district director.

The record described in this paragraph (a) must be retained and kept available for inspection for the 3-year period following the close of the return period to which that record relates.

(2) The person may choose any form of documentation to be used under this section as a record of the preparers employed (or engaged) during a return period. However, the record must disclose on its face which individuals were employed (or engaged) as income tax return preparers during that period.

(3) For the definition of the term "income tax return preparer" (or "preparer") see section 7701(a)(36) and § 301.7701-15. For the definition of the term "return period", see paragraph (b) of this section.

(4) (i) For purposes of this section, any individual who, in acting as an income tax return preparer, is not employed by another income tax return preparer shall be treated as his (or her) own employer. Thus, a sole proprietor shall retain and make available a record with respect to himself (or herself) as provided in this section.

(ii) A partnership shall, for purposes of this section, be treated as the employer of the partners of the partnership and shall retain and make available a record with respect to the partners and others employed (or engaged) by the partnership as provided in this section.

(b) *Return period defined.* For purposes of this section, the term "return period" means the 12-month period beginning on July 1 of each year.

(c) *Penalty.* For the civil penalty for failure to retain and make available a record of the preparers employed (or engaged) during a return period as required under this section, or for failure to include an item in the record required to be retained and made available under this section, see § 1.6695-1(e).

§ 1.6107-1 Income tax return preparer must furnish copy of return to taxpayer and must retain a copy or record.

(a) *Furnishing copy to taxpayer.* The person who is an income tax return preparer of any return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 shall furnish a completed copy of the original return or claim for refund to the taxpayer (or nontaxable entity) not later than the time the original return or claim for refund is presented for the signature of the taxpayer (or nontaxable entity). The preparer may, if it wishes, request a receipt or other evidence from the taxpayer (or nontaxable entity) sufficient to show satisfaction of the requirement of this paragraph (a).

(b) *Copy or record to be retained.* The person who is an income tax return preparer of any return or claim for refund shall—

(1) (i) Retain a completed copy of the return or claim for refund; or

(ii) Retain a record, by list, card file, or otherwise of the name, taxpayer identification number, and taxable year of the taxpayer (or nontaxable entity) for whom the return or claim for refund was prepared and the type of return or claim for refund prepared;

(2) Retain a record, by retention of a copy of the return or claim for refund, maintenance of a list or card file, or otherwise, for each return or claim for refund presented to the taxpayer (or nontaxable entity) of the name of the individual preparer required to sign the return or claim for refund pursuant to § 1.6695-1(b); and

(3) Make the copy or record of returns and claims for refund and record of the individuals required to sign available for inspection upon request by the district director.

The material described in this paragraph (b) shall be retained and kept available for inspection for the 3-year period following the close of the return period during which the return or claim for refund was presented for signature to the taxpayer (or nontaxable entity). However, in the case of a return which becomes due (with extensions, if any) during a return period following the return period during which the return was presented for signature, the material shall be retained and kept available for inspection for the 3-year period following the close of the later return period in which the return became due. For the definition of "return period" see section 6060(c). If the person subject to the record retention requirements of this paragraph (b) is a corporation or a partnership which is dissolved before completion of the 3-year period, then all persons who under state law are responsible for the winding up of the affairs of the corporation or partnership shall be subject, on behalf of the corporation or partnership, to these record retention requirements until completion of the 3-year period. If state law does not specify any person or persons as responsible for winding up, then, collectively, the directors or general partners shall be subject, on behalf of the corporation or partnership, to the record retention requirements of this paragraph (b). For purposes of the penalty imposed by section 6695(d), such designated persons shall be deemed to be the income tax return preparer and will be jointly and severally liable for each failure.

(c) *Preparer.* For the definition of "income tax return preparer", see section 7701(a)(36) and § 301.7701-15. For purposes of applying this section, in the case of—

(1) An employment arrangement between two or more income tax return preparers, the person who employs (or engages) one or more other preparers to prepare for compensation any return or claim for refund other than for the person shall be considered to be the sole income tax return preparer; and

(2) A partnership arrangement for the preparation of returns and claims for refund, the partnership shall be considered to be the sole income tax return preparer.

(d) *Penalties.* (1) For the civil penalty for failure to furnish a copy of the return or claim for refund to the taxpayer (or nontaxable entity) as required under paragraphs (a) and (c) of this section, see section 6695(a) and § 1.6695-1(a).

(2) For the civil penalty for failure to retain a copy of the return or claim for refund, or to retain a record as required under paragraphs (b) and (c) of this section, see section 6695(d) and § 1.6695-1(d).

§ 1.6109-2 Furnishing identifying number of income tax return preparer.

(a) *Furnishing identifying number.* Each return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 prepared by one or more income tax return preparers shall bear the identifying number of the preparer required by § 1.6695-1(b) to sign the return or claim for refund. In addition, if there is a partnership or employment arrangement between two or more preparers, the identifying number of the partnership or the person who employs (or engages) one or more other persons to prepare for compensation the return or claim for refund shall also appear on the return or claim for refund. If the preparer is—

(1) An individual (not described in subparagraph (2) of this paragraph (a)) who is a citizen or resident of the United States, such preparer's social security account number shall be affixed; and

(2) A person (whether an individual, corporation, or partnership) who employs (or engages) one or more persons to prepare the return or claim for refund (other than for the person), or who is not a citizen or resident of the United States and also is not employed or engaged by another preparer, such preparer's employer identification number shall be affixed.

For the definition of the term "income tax return preparer" (or "preparer" see section 7701(a)(36) and § 301.7701-15.

(b) *Furnishing address.* (1) Each return or claim for refund which is prepared by one or more income tax return preparers shall bear the street address, city, State, and postal ZIP code of that preparer's place of business where the preparation of the return or claim for refund was completed. However, if this place of business is not maintained on a year-round basis, the return or claim for refund shall bear the street address, city, State, and postal ZIP code of such preparer's principal office or business location which is maintained on a year-round basis, or if none, that preparer's residence.

(2) For purposes of satisfying the requirement of the first sentence of paragraph (b)(1) of this section, an income tax return preparer may, on returns and claims for refund, disclose only the postal ZIP code of the described place of business as a satisfactory address, but only if the preparer first by written notice advises each affected Internal Revenue Service Center that he intends to follow this practice.

(c) *Penalty.* For the civil penalty for failure to furnish an identifying number as required under paragraph (a) of this section, see section 6695(c) and § 1.6695-1(c).

§ 1.6694-1 Understatement of taxpayer's liability by income tax return preparer.

(a) *Negligent or intentional disregard of rules and regulations.* (1) If any part of an understatement of liability relating to a return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 is due to negligent or intentional disregard of one or more rules or regulations by one or more income tax return preparers of the return or claim for refund, each such preparer shall be subject to a separate penalty of $100. However, an employer or partnership of a preparer subject to this penalty is not also subject to the penalty, unless the employer or partnership (or one or more of its chief officers or general partners) also participated in the negligent or intentional disregard of one or more rules or regulations. A preparer is not considered to have negligently or intentionally disregarded a rule or regulation if the preparer exercises due diligence in an effort to apply the rules and regulations to the information given to the preparer to determine the taxpayer's correct liability for tax.

(2) For the definition of the term "understatement of liability", see section 6694(e) and paragraph (d) of this section.

(3) The term "rules or regulations" includes the provisions of the Internal Revenue Code of 1954, the Treasury regulations issued under the Code, and Internal Revenue Service revenue rulings published in the Cumulative Bulletin.

(4) If a preparer in good faith and with reasonable basis takes the position that a rule or regulation does not accurately reflect the Code and does not follow it, the preparer has not negligently or intentionally disregarded the rule or regulation. This test shall be applied in the same manner as it is applied under section 6653(a) and the regulations thereunder (relating to disregard of rules and regulations by taxpayers). For example, if a preparer reasonably takes the position in good faith that a revenue ruling does not accurately reflect the Code, the preparation of a return or claim for refund by the preparer in conflict with the revenue ruling is not a negligent or intentional disregard of the revenue ruling. For purposes of this paragraph (a), the view of the taxpayer concerning a rule or regulation is not material.

(5) In any proceeding with respect to the penalty imposed by this paragraph (a), the preparer shall bear the burden of proof on the issue whether the preparer has negligently or intentionally disregarded a rule or regulation. If the preparer presents evidence that the normal practice of the preparer concerning the treatment of a particular credit, allowance, deduction, or item of income was not negligent and that this normal practice was followed, the preparer has satisfied the burden of proof that he did not negligently disregard a rule or regulation, unless the Internal Revenue Service presents contrary evidence.

(b) *Willful understatement of liability.* (1) If any part of an understatement of liability relating to a return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 is due to a willful attempt in any manner to understate liability for tax by one or more income tax return preparers of the return or claim for refund, each such preparer shall be subject to a separate penalty of $500. However, an employer or partnership of a preparer subject to this penalty is not also subject to the penalty, unless the employer or partnership (or one or more of its chief officers or general partners) also participated in the willful attempt to understate liability.

(2) (i) A preparer is considered to have willfully attempted to understate liability if the preparer disregards information furnished by the taxpayer or other persons in an attempt wrongfully to reduce the tax liability of the taxpayer. For example, if a preparer disregards information concerning certain items of taxable income furnished by the taxpayer or other persons, the preparer would be subject to the penalty. Similarly, if a taxpayer states to a preparer that the taxpayer has only two dependents, and the preparer reports six dependents on the return, the preparer would be subject to the penalty.

(ii) Generally, in preparing a return, the preparer may in good faith rely without verification upon information furnished by the taxpayer. To avoid the penalty, the preparer is not required to examine or review documents or other evidence in order to verify independently the taxpayer's information. However, the preparer may not ignore the implications of information furnished. The preparer shall make reasonable inquiries if the information as furnished appears to be incorrect or incomplete. Additionally, many sections of the Code require the existence of specific facts and circumstances, such as maintenance of specific documentation, before a deduction may be properly claimed. The preparer shall make appropriate inquiries of the taxpayer to determine the existence of facts and circumstances required by a Code section or regulations incident to claiming a deduction.

(iii) For example, assume that a taxpayer, during the tax interview conducted by a preparer, stated that he had paid $2,500 in doctor bills and $4,000 in deductible travel and entertainment expenses during the tax year when in fact he had paid smaller amounts. On the basis of the information, the preparer properly calculated deductions for medical expenses and for travel and entertainment expenses which resulted in an understatement of liability for tax. The preparer had no reason to believe that the medical expense and travel and entertainment expense information presented was incorrect or incomplete. The preparer did not ask for underlying documentation of the medical expenses and, upon inquiry, was reasonably satisfied by the taxpayer's representations that the taxpayer had adequate records (or other sufficient corroborative evidence) for the deduction of $4,000 for travel and entertainment expenses. The preparer is not subject to the penalty.

(iv) In certain situations, a preparer shall be subject both to a penalty under paragraph (a) of this section for intentional disregard of rules and regulations and to a penalty under this paragraph (b) for willful understatement of liability. A penalty for willful understatement of liability may be based on an intentional disregard of rules and regulations. For example, a preparer who claims a personal exemption deduction for the taxpayer's mother with knowledge that the taxpayer is not entitled to the deduction will have both intentionally disregarded rules and regulations within the meaning of paragraph (a) of this section and willfully understated liability for tax within the meaning of this paragraph (b).

(3) For the definition of the term "understatement of liability", see section 6694(e) and paragraph (d) of this section.

(4) If a penalty is assessed against a preparer, and collected at least in part, under paragraph (a) of this section for a return or claim for refund, then the amount of a penalty for which the preparer may be subject under this paragraph (b) for the same return or claim for refund is $500, reduced by the amount collected under paragraph (a) of this section for the return or claim for refund.

(5) In any proceeding with respect to the penalty imposed by this paragraph (b), the Internal Revenue Service shall bear the burden of proof on the issue whether the preparer has willfully attempted to understate the liability for tax. See section 7427.

(c) *Abatement of penalty where taxpayer's liability not understated.* If a penalty or penalties under section 6694(a) and paragraph (a) of this section or under section 6694(b) and paragraph (b) of this section concerning a return or claim for refund have been assessed against one or more income tax return preparers, and if at any time in a final administrative determination or a final judicial decision it is established that there was no understatement of liability relating to the return or claim for refund, then—

(1) The assessment shall be abated; and

(2) If any amount of the penalty or penalties was paid, that amount shall be refunded to the person or persons who so paid, as if the payment were an overpayment of tax, without consideration of any period of limitations.

(d) *Understatement of liability defined.* For purposes of this section, an "understatement of liability" exists, if viewing the return or claim for refund as a whole, there is an understatement of the net amount payable of any tax under subtitle A of the Internal Revenue Code of 1954, or an overstatement of the net amount creditable or refundable of any tax under subtitle A of the Internal Revenue Code of 1954. Tax under subtitle A of the Internal Revenue Code of 1954 does not include the additions to the tax provided by section 6654 and section 6655 (relating to underpayment of estimated tax). Except as provided in paragraph (c) of this section, the determination of whether an understatement of liability exists may be made in a proceeding involving the preparer apart from any proceeding involving the taxpayer.

§ 1.6694-2 Extension of period of collection where preparer pays 15 percent of a penalty for understatement of taxpayer's liability and certain other procedural matters.

(a) *In general.* (1) The Internal Revenue Service shall investigate the preparation by the income tax return preparer of the return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 and shall send a report of examination to the preparer before the assessment of either—

(i) The penalty for negligent or intentional disregard of rules and regulations under § 1.6694-1(a); or

(ii) The penalty for willful understatement of liability under § 1.6694-1(b).

Unless the period of limitation (if any) under section 6696(d) may expire without adequate opportunity for assessment, the Internal Revenue Service shall also, before the

assessment of either penalty, send a 30-day letter to the preparer notifying him of the proposed penalty or penalties and offering an opportunity to the preparer to request further administrative consideration and a final administrative determination by the Internal Revenue Service concerning the assessment. If the preparer then makes a timely request, assessment may not be made until the Internal Revenue Service makes a final administrative determination adverse to the preparer.

(2) If the Internal Revenue Service assesses either of the two penalties described in paragraph (a)(1) (i) and (ii) of the section, it shall send to the preparer a statement of notice and demand, separate from any notice of a tax deficiency, for payment of the amount assessed.

(3) Within 30 days after the day on which notice and demand of either of the two penalties described in paragraph (a)(1) (i) and (ii) of this section is made against the preparer, that preparer shall either—

(i) Pay the entire amount assessed (and may file a claim for refund of the amount paid at any time not later than 3 years after the date of payment); or

(ii) Pay an amount which is not less than 15 percent of the entire amount assessed and shall file a claim for refund of the entire amount paid.

(4) If the preparer pays an amount and files a claim for refund under paragraph (a)(3)(ii) of this section, the Internal Revenue Service may not make, begin, or prosecute a levy or proceeding in court for collection of the unpaid remainder of the amount assessed until—

(i) A date which is more than 30 days after the earlier of—

(A) The day on which the preparer's claim for refund is denied; or

(B) The expiration of 6 months after the day on which the preparer filed the claim for refund; and

(ii) Final resolution of any proceeding begun as provided in paragraph (b) of this section.

Final resolution of a proceeding includes any settlement between the Internal Revenue Service and the preparer, any final determination by the court (for which the period for appeal, if any, has expired), and, generally, the types of determinations provided under section 1313(a) (relating to taxpayer deficiencies). Notwithstanding section 7421(a) (relating to suits to restrain assessment or collection), the beginning of a levy or proceeding in court by the Internal Revenue Service in contravention of this subparagraph (4) may be enjoined by a proceeding in the proper court.

(b) *Preparer must bring suit in district court to determine liability for penalty.* (1) If, within 30 days after the earlier of—

(i) The day on which the preparer's claim for refund filed under paragraph (a)(3)(ii) of this section is denied; or

(ii) The expiration of 6 months after the day on which the preparer filed the claim for refund the preparer fails to begin a proceeding for refund in the appropriate United States district court, then the Internal Revenue Service may proceed with collection of the amount of the penalty not paid under paragraph (a)(3)(ii) of this section.

(2) (i) If the preparer begins a proceeding for refund within the applicable 30-day period of paragraph (b)(1) of this section, then the Internal Revenue Service may not make, begin, or prosecute a levy or proceeding in court for collection of the unpaid remainder of the penalty until final resolution of the proceeding.

(ii) If the preparer begins a proceeding for refund under this paragraph (b), then the Internal Revenue Service need not bring a counterclaim in the proceeding for the unpaid remainder of the penalty, because any judicial decision on the refund will apply as well to the unpaid remainder of the penalty.

(c) *Suspension of running of period of limitations on collection.*—The running of the period of limitations provided in section 6502 on the collection by the levy or by a proceeding in court of the unpaid amount of a penalty or penalties described in § 1.6694-1 (a) or (b) shall be suspended for the period during which the Internal Revenue Service, under paragraphs (a)(4) and (b)(2)(i) of this section, may not collect the unpaid amount of the penalty or penalties by levy or a proceeding in court.

§ 1.6695-1 Other assessable penalties with respect to the preparation of income tax returns for other persons.

(a) *Failure to furnish copy to taxpayer.* (1) A person who is an income tax return preparer of any return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 and who fails to satisfy the requirement imposed upon him by section 6107(a) and § 1.6107-1(a) and (c) to furnish a copy of the return or claim for refund to the taxpayer (or nontaxable entity) shall be subject to a penalty of $25 for the failure, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. Thus, no penalty may be imposed under section 6695(a) and this paragraph (a)(1) upon a person who is an income tax return preparer solely by reason of—

(i) Section 301.7701-15(a)(2) and (b) on account of having given advice on specific issues of law; or

(ii) Section 301.7701-15(b)(3) on account of having prepared the return solely because of having prepared another return which affects amounts reported on the return.

(2) No penalty may be imposed under section 6695(a) and paragraph (a)(1) of this section upon an income tax return preparer who furnishes a copy of the return or claim for refund to a taxpayer—

(i) Who holds an elected or politically appointed position with the government of the United States or a State or political subdivision thereof; and

(ii) Who, in order faithfully to carry out his official duties, has so arranged his affairs that he has less than full knowledge of the property which he holds or of the debts for which he is responsible, if information is deleted from the copy in order to preserve or maintain this arrangement.

(b) *Failure to sign return.* (1) An individual who is an income tax return preparer with respect to a return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 shall manually sign the return or claim for refund (which may be a photocopy) in the appropriate space provided on the return or claim for refund after it is completed and before it is presented to the taxpayer (or nontaxable entity) for signature. Except as provided in paragraph (b)(4)(iii) of this section, an individual preparer may not satisfy this requirement by use of a facsimile signature stamp or signed gummed label. If the preparer is unavailable for signature, another preparer shall review the entire preparation of the return or claim for refund, and then shall manually sign the return or claim for refund.

(2) If more than one income tax return preparer is involved in the preparation of the return or claim for refund, the individual preparer who has the primary responsibility as between or among the preparers for the overall substantive accuracy of the preparation of such return or claim for refund shall be considered to be the income tax return preparer for purposes of this paragraph.

(3) The application of paragraph (b) (1) and (2) of this section is illustrated by the following examples:

Example (1). X law firm employs Y, a lawyer, to prepare for compensation returns and claims for refund of taxes. X is employed by T, a taxpayer, to prepare his 1977 Federal tax return. X assigns Y to prepare T's return. Y obtains the information necessary for completing the return from T and makes determinations with respect to the proper application of the tax laws to such information in order to determine T's tax liability. Y then forwards such information to C, a computer tax service which performs the mathematical computations and prints the return form by means of computers. C then sends the completed return to Y who reviews the accuracy of the return. Y is the individual preparer who is primarily responsible for the overall accuracy of T's return. Y must sign the return as preparer.

Example (2). X partnership is a national accounting firm which prepares for compensation returns and claims for refund of taxes. A and B, employees of X, are involved in preparing the 1977 tax return of T Corporation. After they complete the return, including the gathering of the necessary information, the proper application of the tax laws to such information, and the performance of the necessary mathematical computations, C, a supervisory employee of X, reviews this return. As part of this review, C reviews the information provided and the application of the tax laws to this information. The mathematical computations and carried-forward amounts are proved by D, an employee in X's comparing and proving department. The policies and practices of X require that P, a partner, finally review the return. The scope of P's review includes reviewing the information provided by applying to this information his knowledge of T's affairs, observing that X's policies and practices have been followed, and making the final determination with respect to the proper application of the tax laws to determine T's tax liability. P may or may not exercise these responsibilities, or may exercise them to a greater or lesser extent, depending on the degree of complexity of the return, his confidence in C (or A and B), and other factors. P is the individual preparer who is primarily responsible for the overall accuracy of T's return. P must sign the return as preparer.

Example (3). C Corporation maintains an office in Seattle, Washington, for the purpose of preparing for compensation returns and claims for refund of taxes. C makes compensatory arrangements with individuals (but provides no working facilities) in several

States to collect information from taxpayers and to make determinations with respect to the proper application of the tax laws to the information in order to determine the tax liabilities of such taxpayers. E, an individual, who has such an arrangement in Los Angeles with C, collects information from T, a taxpayer, and completes a worksheet kit supplied by C which is stamped with E's name and an identification number assigned to E by C. In this process, E classifies this information in appropriate income and deduction categories for the tax determination. The completed worksheet kit signed by E, is then mailed to C. D, an employee in C's office, reviews the worksheet kit to make sure it was properly completed. D does not review the information obtained from T for its validity or accuracy. D may, but did not, make the final determination with respect to the proper application of tax laws to the information. The data from the worksheet is entered into a computer and the return form is completed. The return is prepared for submission to T with filing instructions. E is the individual preparer primarily responsible for the overall accuracy of T's return. E must sign the return as preparer.

Example (4). X employs A, B, and C to prepare income tax returns for taxpayers. After A and B have collected the information from the taxpayer and applied the tax laws to the information, the return form is completed by computer service. On the day the returns prepared by A and B are ready for their signatures, A is away from the city for 1 week on another assignment and B is on detail to another office for the day. C may sign the returns prepared by A, provided that (i) C reviews the information obtained by A relative to the taxpayer, and (ii) C reviews the preparation of each return prepared by A. C may not sign the returns prepared by B because B is available.

(4) (i) The manual signature requirement of paragraph (b) (1) and (2) of this section may be satisfied by a photocopy of a copy of the return or claim for refund which copy is manually signed by the preparer after completion of its preparation. After a copy of the return or claim for refund is signed by the preparer and before it is photocopied, no person other than the preparer may alter any entries on the copy other than to correct arithmetical errors discernible on the return or claim for refund. The employer of the preparer or the partnership in which the preparer is a partner, or the preparer (if not employed or engaged by a preparer and not a partner of a partnership which is a preparer), shall retain the manually signed copy of the return or claim for refund. A record of any arithmetical errors corrected shall be retained by the person required to retain the manually signed copy of the return or claim for refund and made available upon request.

(ii) If mechanical preparation of the return or claim for refund is accomplished by computer not under the control of the individual preparer, then the manual signature requirement of paragraph (b) (1) and (2) of this section may be satisfied by a manually signed attestation by the individual preparer attached to the return or claim for refund that all the information contained in the return or claim for refund was obtained from the taxpayer and is true and correct to the best of his knowledge, but only if that information (including any supplemental written information provided and signed by the preparer) is not altered on the return or claim for refund by another person. For purposes of the preceding sentence, the correction of arithmetical or clerical errors, discernible from the information submitted by the preparer does not constitute an alteration. The information submitted by the preparer shall be retained by the employer of the preparer or by the partnership in which the preparer is a partner, or by the preparer (if not employed or engaged by a preparer and not a partner in a partnership which is a preparer). A record of any arithmetical or clerical errors corrected shall be retained by the person required to retain the information submitted by the preparer and made available upon request.

(iii) A preparer of a return or claim for refund for a nonresident alien individual taxpayer who is authorized to sign the return or claim for refund for the taxpayer may satisfy the manual signature requirement of paragraph (b) (1) and (2) of this section by a facsimile signature if the preparer is permitted to use a facsimile signature in signing the return or claim for refund for the taxpayer. This subdivision (iii) shall apply only if the preparer submits to the Internal Revenue Service with the returns or claims for refund bearing the preparer's facsimile signature a letter, manually signed by the preparer, identifying by taxpayer name and identification number each return or claim for refund bearing the facsimile signature and declaring that the facsimile signature appearing on these returns or claims for refund is the signature used by the preparer to sign these documents. After the facsimile signature is affixed, no person other than the preparer may alter any entries on the return or claim for refund other than to correct arithmetical errors discernible on the return or claim for refund. The employer of the preparer or the partnership in which the preparer is a partner, or the preparer (if not employed or engaged by a preparer and not a partner in a partnership which is a preparer) shall retain a manually signed copy of the letter submitted to the Internal Revenue Service with the returns or claims for refund. A record of any arithmetical errors corrected shall be retained by the person required to retain the manually signed letter and made available upon request.

(iv) Any items required to be retained and kept available for inspection under subdivision (i), (ii), or (iii) of this subparagraph (4) shall be retained and kept available for inspection for the same period that the material described in § 1.6107-1(b) must be retained and kept available for inspection.

(v) If the district director determines that a preparer or preparers have abused the permissive signature rules of this subparagraph (4) such as by altering the return or claim for refund after signature (in contravention of subdivision (i) of this subparagraph), by altering information on the return or claim for refund after attestation (in contravention of subdivision (ii) of this subparagraph), or by failing to comply with the provisions of subdivision (iii) of this subparagraph, then the district director may, by written notice, prospectively deny to the preparer or preparers the right to use these permissive signature rules.

(5) An individual required by this paragraph (b) to sign a return or claim for refund shall be subject to a penalty of $25 for each failure to sign, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. For purposes of this paragraph, "reasonable cause" is a cause which arises despite ordinary care and prudence exercised by the individual preparer. Thus, no penalty may be imposed under section 6695(b) and this paragraph (b) upon a person who is an income tax return preparer solely by reason of—

(i) Section 301.7701-15 (a)(2) and (b) on account of having given advice on specific issues of law; or

(ii) Section 301.7701-15(b)(3) on account of having prepared the return solely because of having prepared another return which affects amounts reported on the return. If the preparer asserts reasonable cause for failure to sign, the Service shall require a written statement in substantiation of the preparer's claim of reasonable cause.

(c) *Failure to furnish identifying number.* (1) A person who is an income tax return preparer of any return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 and who fails to satisfy the requirement of section 6109(a)(4) and § 1.6109-2(a) to furnish one or more identifying numbers of preparers on a return or claim for refund shall be subject to a penalty of $25 for the failure, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. Thus, no penalty may be imposed under section 6695(c) and this paragraph (c)(1) upon a person who is an income tax return preparer solely by reason of—

(i) Section 301.7701-15 (a)(2) and (b) on account of having given advice on specific issues of law; or

(ii) Section 301.7701-15(b)(3) on account of having prepared the return solely because of having prepared another return which affects amounts reported on the return.

(2) No penalty may be imposed under section 6695(c) and paragraph (c)(1) of this section upon—

(i) A preparer who is employed (or engaged) by a person who is also a preparer of the return or claim for refund, or

(ii) A preparer who is a partner in a partnership which is also a preparer of the return or claim for refund.

(3) No more than one penalty of $25 may be imposed under section 6695(c) and paragraph (c)(1) of this section with respect to a single return or claim for refund.

(d) *Failure to retain copy or record.* (1) A person who is an income tax return preparer of any return of tax under subtitle A of the Internal Revenue Code of 1954 or claim for refund of tax under subtitle A of the Internal Revenue Code of 1954 and who fails to satisfy the requirements imposed upon him by section 6107(b) and § 1.6107-1 (b) and (c) (other than the record requirement described in both § 1.6107-1(b) (2) and (3)) to retain and make available a copy of the return or claim for refund, or to include the return or claim for refund in a record of returns and claims for refund and make the record available for inspection, shall be subject to a penalty of $50 for the failure, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. Thus, no penalty may be imposed under section 6695(d) and this paragraph (d) (1) upon a person who is an income tax return preparer solely by reason of—

(i) Section 301.7701-15 (a)(2) and (b) on account of having given advice on specific issues of law; or

(ii) Section 301.7701-15(b)(3) on account of having prepared the return solely because of having prepared another return which affects amounts reported on the return.

(2) A person may not, for returns or claims for refund presented to the taxpayers (or nontaxable entities) during any single return period, be subject to more than $25,000 in penalties under section 6695(d) and paragraph (d)(1) of this section.

(e) *Failure to comply with reporting requirements.* A person who is subject to the reporting requirements of section 6060 and § 1.6060-1 and who fails to satisfy these requirements shall be subject to the following penalties, unless it is shown that the failure is due to reasonable cause and not due to willful neglect.

(1) $100, for failure to retain and make available a record of the preparers employed (or engaged) during a return period as required under § 1.6060-1, plus

(2) $5, for each failure to include a required item in the record required to be retained and made available under § 1.6060-1.

A person may not, for failure to satisfy the reporting requirements with respect to any single return period, be subject to more than $20,000 in penalties under section 6695(e) and this section.

(3) The amount of any penalty under section 6695(e) and this section for failure to retain and make available a record of the preparers employed (or engaged) during a return period or for failure to include a required item in that record must be assessed within 3 years after the close of the return period to which the record relates, and no proceeding in court without assessment for the collection of the penalty may be begun after the expiration of this period.

(f) *Negotiation of check.* (1) No person who is an income tax return preparer may endorse or otherwise negotiate, directly or through an agent, a check for the refund of tax under subtitle A of the Internal Revenue Code of 1954 which is issued to a taxpayer other than the preparer if the person was a preparer of the return or claim for refund which gave rise to the refund check.

(2) Section 6695(f) and paragraph (f)(1) and (3) of this section do not apply to a preparer-bank which—

(i) Cashes a refund check and remits all of the cash to the taxpayer or accepts a refund check for deposit in full to a taxpayer's account, so long as the bank does not initially endorse or negotiate the check (unless the bank has made a loan to the taxpayer on the basis of the anticipated refund); or

(ii) Endorses a refund check for deposit in full to a taxpayer's account pursuant to a written authorization of the taxpayer (unless the bank has made a loan to the taxpayer on the basis of the anticipated refund).

A preparer-bank may also subsequently endorse or negotiate a refund check as a part of the check-clearing process through the financial system after initial endorsement or negotiation.

(3) The preparer shall be subject to a penalty of $500 for each endorsement or negotiation of a check prohibited under section 6695(f) and paragraph (f)(1) of this section.

PART 301—PROCEDURE AND ADMINISTRATION

§ 301.7216-1 Penalty for disclosure or use of tax return information.

(a) *In general.* Section 7216(a) provides in effect that, except as provided in section 7216(b), any tax return preparer (as described in paragraph (b)(2) of this section) who on or after January 1, 1972, discloses or uses any tax return information (as described in paragraph (b)(3) of this section) other than for the specific purpose of preparing, assisting in preparing, or obtaining or providing services in connection with the preparation of, any tax return of the taxpayer by or for whom the information was made available to a tax return preparer, shall be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than $1,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution. Pursuant to section 7216(b), the provisions of section 7216(a) and this paragraph do not apply to any disclosure or use permitted under § 301.7216-2 or § 301.7216-3.

(b) *Definitions.* For purposes only of section 7216 and §§ 301.7216-1 through 301.7216-3—

(1) *Tax return.* The term "tax return" means any return (or amended return) of the income tax imposed by chapter 1 or 2 of the Code, or any declaration (or amended declaration) of estimated tax made under section 6015.

(2) *Tax return preparer.* (i) The term "tax return preparer" means any person—

(A) Who is engaged in the business of preparing tax returns,

(B) Who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns,

(C) Who is remunerated for preparing, or assisting in preparing, a tax return for any other person, or

(D) Any individual who, as part of his duties or employment with any person described in (A), (B), or (C) of this subdivision, performs services which assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, a tax return.

For example, assume that a bank is a tax return preparer within the meaning of (A) of this subdivision and it employs one individual to solicit the necessary tax return information for the preparation of a tax return and another individual to prepare the return on the basis of the information that is furnished. Under these circumstances, both employees are tax return preparers. Also, for example, a secretary to a tax return preparer who types or otherwise works on returns prepared by the preparer is a tax return preparer.

(ii) A person is engaged in the business of preparing tax returns as described in subdivision (i)(A) of this subparagraph if, in the course of his business, he holds himself out to taxpayers as a person who prepares tax returns, whether or not tax return preparation is his sole business activity and whether or not he charges a fee for such services.

(iii) A person is engaged in the business of providing auxiliary services in connection with the preparation of tax returns as described in subdivision (i)(B) of this subparagraph if, in the course of his business, he holds himself out to tax return preparers or to taxpayers as a person who performs such auxiliary services, whether or not providing such auxiliary services is his sole business activity and whether or not he charges a fee for such services. For example, a person part or all of whose business is to provide a computerized tax return processing service based on tax return information furnished by another person is a tax return preparer.

(iv) A tax return preparer described in subdivision (i)(C) of this subparagraph includes any person who—

(A) For remuneration but not in the course of a business prepares a tax return for another person, or

(B) For remuneration and on a casual basis helps a relative, friend, or other acquaintance to prepare the latter's tax return.

(v) A person is not a tax return preparer merely because he leases office space to a tax return preparer, furnishes credit to a taxpayer whose tax return is prepared by a tax return preparer, or otherwise performs some service which only incidentally relates to the preparation of tax returns. For example, assume that a tax return preparer contracts with a department store for the rental of space in the store, and that the store advertises that taxpayers who use the tax return preparation service may charge the cost of having their tax return prepared to their charge account with the department store. Under such circumstances, the department store is not a tax return preparer.

(3) *Tax return information.* The term "tax return information" means any information, including but not limited to a taxpayer's name, address, or identifying number, which is furnished in any form or manner by a taxpayer for, or in connection with, the preparation of a tax return of such taxpayer. Information furnished by a taxpayer includes information which is furnished on behalf of the taxpayer by any person; for example, any person required under section 6012 to make a return for such taxpayer, such as a guardian for a minor, by a duly authorized agent for his principal, by a fiduciary for an estate or trust, or by a receiver, trustee in bankruptcy, or assignee for a corporation.

§ 301.7216-2 Disclosure or use without formal consent of taxpayer.

(a) *Disclosure pursuant to other provisions of Internal Revenue Code.* The provisions of section 7216(a) and § 301.7216-1 shall not apply to any disclosure of tax return information if such disclosure is made pursuant to any other provision of the Code or the regulations thereunder. Thus, for example, the provisions of such sections do not apply to a disclosure pursuant to section 7269 to an officer or employee of the Internal Revenue Service of information concerning the estate of a decedent or a disclosure pursuant to section 7602 to an officer or employee of the Internal Revenue Service of books, papers, records, or other data which may be relevant to the liability of any person for the income tax.

(b) *Disclosure or use of information in the case of related taxpayers.* (1) A tax return preparer may use, in preparing a tax return of a second taxpayer, and may disclose to such second taxpayer in the form in which it appears on such return, any tax return information which the preparer obtained from a first taxpayer if—

(i) The second taxpayer is related to the first taxpayer within the meaning of subparagraph (2) of this paragraph,

(ii) The first taxpayer's tax interest in such information is not adverse to the second taxpayer's interest in such information, and

(iii) The first taxpayer has not expressly prohibited such disclosure or use.

(2) For purposes of subparagraph (1) (i) of this paragraph, one taxpayer is related to another taxpayer if they have any one of the following relationships: husband and wife, child and parent, grandchild and grandparent, partner and partnership, trust or estate and beneficiary, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations as defined in section 1563.

(3) See § 301.7216-3(a)(3) for disclosure or use of tax return information of the taxpayer in preparing the tax return of a second taxpayer where the requirements of this paragraph are not satisfied.

(c) *Disclosure pursuant to an order of a court or a Federal or State agency.* The provisions of section 7216(a) and § 301.7216-1 do not apply to any disclosure of tax return information if such disclosure is made pursuant to any one of the following documents:

(1) The order of any court of record, Federal, State, or local, or

(2) A subpoena issued by a grand jury, Federal or State, or

(3) An administrative order, demand, summons or subpoena which is issued in the performance of its duties by—

(i) Any Federal agency, or

(ii) A State agency, body, or commission charged under the laws of the State or a political subdivision of the State with the licensing, registration, or regulation of tax return preparers. Information must be clearly identified in the document in order to be disclosed under this paragraph (c).

(d) *Disclosure for use in revenue investigations or court proceedings.* A tax return preparer may disclose tax return information (1) to his attorney, or to an employee of the Internal Revenue Service, for use in connection with an investigation of such tax return preparer conducted by the Internal Revenue Service or (2) to his attorney, or to any officer of a court, for use in connection with proceedings involving such tax return preparer before the court, or before any grand jury which may be convened by the court.

(e) *Certain disclosure by attorneys and accountants.* The provisions of section 7216(a) and § 301.7216-1 do not apply to any disclosure of tax return information permitted by this paragraph (e).

(1) A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer may use the tax return information of the taxpayer, or disclose such information to another employee or member of the preparer's law or accounting firm who may use it, to render other legal or accounting services to or for such taxpayer. Thus, for example, a lawyer who prepares a tax return for a taxpayer may use the tax return information of the taxpayer for, or in connection with, rendering legal services, such as estate planning or administration, or preparation of trial briefs or trust instruments, for the taxpayer or the estate of the taxpayer; or if another member of the same firm renders the other legal services for the taxpayer, the lawyer who prepared the tax return may disclose the tax return information to that other member for use in rendering those services for the taxpayer. In further illustration, an accountant who prepares a tax return for a taxpayer may use the tax return information, or disclose it to another member of the firm for use, for, or in connection with, the preparation of books of account, working papers, or accounting statements or reports to or for the taxpayer. Further, in the normal course of rendering such legal or accounting services to or for the taxpayer, the attorney or accountant may, with the express or implied consent of the taxpayer, make such tax return information available to third parties, such as stockholders, management, suppliers, or lenders.

(2) A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer may (i) take such tax return information into account, and may act upon it, in the course of performing legal or accounting services for a client other than the taxpayer or (ii) disclose such information to another employee or member of the preparer's law or accounting firm to enable that other employee or member to take the information into account, and act upon it, in the course of performing legal or accounting services for a client other than the taxpayer, when such information is or may be relevant to the subject matter of such legal or accounting service for the other client and its consideration by those performing the services is necessary for the proper performance by them of such services. In no event, however, may such tax return information be disclosed to a person who is not an employee or member of the law or accounting firm unless such disclosure is exempt from the application of section 7216(a) and § 301.7216-1 by reason of another provision, other than this paragraph, of § 301.7216-2 or § 301.7216-3.

(3) The application of this paragraph may be illustrated by the following examples:

Example (1). A, a member of an accounting firm, renders an opinion on a financial statement of M Corporation that is part of a registration statement filed with the Securities and Exchange Commission. After the filing of such registration statement, but before its effective date, B, a member of the same accounting firm, prepares an income tax return for N Corporation. In the course of preparing such income tax return, B discovers that N does business with M and concludes that information he is given by N should be considered by A to determine whether the financial statement reported on by A contains an untrue statement of material fact or omitted to state a material fact required to keep the statement from being misleading. B discloses to A the tax return information of N for this purpose. A determines that there is an omission of material fact and that an amended statement should be filed. A so advises M and the Securities and Exchange Commission. A explains that the omission was revealed as a result of confidential information which came to A's attention after the statement was filed, but A does not disclose the identity of the taxpayer or the tax return information itself. Section 7216(a) and § 301.7216-1 do not apply to the foregoing disclosure of N's tax return information by B to A and the use of such information by A in advising M and the Securities and Exchange Commission of the necessity for filing an amended statement. Section 7216(a) and § 301.7216-1 would apply to a disclosure of N's tax return information to M or to the Securities and Exchange Commission unless such disclosure is exempt from the application of section 7216(a) and § 301.7216-1 by reason of another provision of either § 301.7216-2 or § 301.7216-3.

Example (2). A, a member of an accounting firm, is conducting an audit of M Corporation, and B, a member of the same accounting firm, prepares an income tax return for D, an officer of M. In the course of preparing such return, B obtains information from D indicating that D, pursuant to an arrangement with a supplier doing business with M, has been receiving from the supplier, a percentage of the amounts which the supplier invoices to M. B discloses this information to A who, acting upon it, searches in the course of the audit for indications of such kickback scheme. As a result, A discovers information from audit sources which also, but independently, indicates the existence of such a scheme. Without revealing the tax return information A has received from B, A brings to the attention of officers of M the audit information indicating the existence of the kickback scheme. Section 7216(a) and § 301.7216-1 do not apply to the foregoing disclosure of D's tax return information by B to A, the use by A of such information in the course of the audit, and the disclosure by A to M of the audit information indicating the existence of the kickback scheme. See also § 301.7216-2(j). Section 7216(a) and § 301.7216-1 would apply to a disclosure to M, or to any other person not an employee or member of the accounting firm, of D's tax return information furnished to B.

(f) *Corporate fiduciaries.* A trust company, trust department of a bank, or other corporate fiduciary which prepares a tax return for a taxpayer to or for whom it renders fiduciary, investment, or other custodial or management services may (1) disclose or use the tax return information of such taxpayer in the ordinary course of rendering such services to or for the taxpayer or (2), with the express or implied consent of the taxpayer, make such information available to the taxpayer's attorney, accountant, or investment advisor.

(g) *Disclosure to taxpayer's fiduciary.* If after furnishing tax return information to a tax return preparer the taxpayer dies or becomes incompetent, insolvent, or bankrupt, or his assets are placed in conservatorship or receivership, the tax return preparer may disclose such information to the duly appointed fiduciary of the taxpayer or his estate, or to the duly authorized agent of such fiduciary.

(h) *Disclosure by tax return preparer to tax return processor.* A tax return preparer may disclose tax return information of a taxpayer to another tax return preparer described in § 301.7216-1(b)(2)(i)(B) for the purpose of having the second tax return preparer transfer that information to, and compute the tax liability on, a tax return of such taxpayer by means of electronic, mechanical, or other form of tax return processing service.

(i) *Disclosure by one officer, employee, or member to another officer, employee, or member.* An officer, employee, or member of a tax return preparer may transfer any tax return information to another officer, employee, or member of the same tax return preparer for the purpose of performing services which assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the tax return of a taxpayer by or for whom the information was furnished.

(j) *Identical information obtained from other sources.* The provisions of section 7216(a) and § 301.7216-1 shall not apply to the disclosure or use by a tax return preparer of information which is identical to any tax return information which has been furnished to him if such identical information was obtained otherwise than in connection with the preparation of, or providing auxiliary services in connection with the preparation of, a tax return.

(k) *Disclosure or use of information in preparation or audit of State returns.* The provisions of section 7216(a) and § 301.7216-1 shall not apply to the disclosure or use by any tax return preparer of any tax return information in the preparation or audit of, or in connection with the preparation or audit of, any tax return or declaration of estimated tax required of the taxpayer under the law of any State or political subdivision thereof, of the District of Columbia, or of any possession of the United States.

(l) *Retention of records.* A tax return preparer may retain tax return information of a taxpayer, including copies of tax returns or data processing tapes prepared on the basis of such tax return information, and may use such information in connection with the preparation of other tax returns of the taxpayer or in connection with an audit by the Internal Revenue Service of any tax return. The provisions of paragraph (m) of this section respecting the transfer of a taxpayer list apply also to the transfer of any records and related workpapers to which this paragraph applies.

(m) *Lists for solicitation of tax return business.* Any tax return preparer may compile and maintain a separate list containing the names and addresses of taxpayers whose tax returns he has prepared or processed. This list may be used by the compiler solely to contact the taxpayers on the list for the purpose of offering tax information or additional tax return preparation services to such taxpayers. The compiler of the list may not transfer the taxpayer list, or any part thereof, to any other person unless such transfer takes place in conjunction with the sale or other disposition of the tax return preparation business of such compiler. A person who acquires a taxpayer list, or a part thereof, in conjunction with such a sale or other disposition shall be subject to the provisions of this paragraph with respect to such list as if he had been the compiler of such list. The term "list," as used in this paragraph, includes any record or system whereby the names and addresses of taxpayers are retained.

(n) *Disclosure to report the commission of a crime.* The provisions of section 7216(a) and § 301.7216-1 do not apply to the disclosure of any tax return information to the proper Federal, State or local official in order, and to the extent necessary, to inform the official of activities which may constitute, or may have constituted, a violation of any criminal law. In addition, such a disclosure made in the bona fide but mistaken belief that the activities constituted a violation of criminal law is not subject to section 7216(a) and § 301.7216-1.

§ 301.7216-3 Disclosure or use only with formal consent of taxpayer.

(a) *Written consent to use or disclose*—(1) *Solicitation of other business.* (i) If a tax return preparer has obtained from the taxpayer a consent described in paragraph (b) of this section, he may use the tax return information of such taxpayer to solicit from the taxpayer any additional current business, in matters not related to the Internal Revenue Service, which the tax return preparer provides and offers to the public. The request for such consent may not be made later than the time the taxpayer receives his completed tax return from the tax return preparer. If the request is not granted, no follow up request may be made. This authorization to use tax return information of the taxpayer does not apply, however, for purposes of facilitating the solicitation of the taxpayer's use of any services or facilities furnished by a person other than the tax return preparer, unless such other person and the tax return preparer are members of the same affiliated group within the meaning of section 1504. Thus, for example, the authorization would not apply if the other person is a corporation which is owned or controlled directly or indirectly by the same interests which own or control the tax return preparer but which is not affiliated with the tax return preparer within the meaning of section 1504(a). Moreover, this authorization does not apply for purposes of facilitating the solicitation of additional business to be furnished at some indefinite time in the future, as, for example, the future sale of mutual fund shares or life insurance, or the furnishing of future credit card services. It is not necessary, however, that the additional business be furnished in the same locality in which the tax return information is furnished.

(ii) For prohibition against solicitation of employment in matters related to the Internal Revenue Service, see 31 CFR 10.30 (Treasury Department Circular No. 230) and § 8 of Rev. Proc. 81-38, 1981-2 C.B. 592.

(2) *Permissible disclosures to third parties.* If a tax return preparer has obtained from a taxpayer a consent described in paragraph (b) of this section, he may disclose the tax return information of such taxpayer to such third persons as the taxpayer may direct. However, see § 301.7216-2 for certain permissible disclosures without formal written consent.

(3) *Disclosure or use of information in connection with another person's return.* A tax return preparer may disclose or use any tax return information, which was obtained from a first taxpayer, in preparing a tax return of a second taxpayer if the tax return preparer has obtained from the first taxpayer a written consent described in paragraph (b) of this section. See § 301.7216-2(b) for disclosure or use in certain cases without formal consent.

(b) *Form of consent.* A separate written consent, signed by the taxpayer or his duly authorized agent or fiduciary, must be obtained for each separate use or disclosure authorized in paragraph (a)(1), (2), or (3) of this section and shall contain—

(1) The name of the tax return preparer,

(2) The name of the taxpayer,

(3) The purpose for which the consent is being furnished,

(4) The date on which such consent is signed,

(5) A statement that the tax return information may not be disclosed or used by the tax return preparer for any purpose (not otherwise permitted under § 301.7216-2) other than that stated in the consent, and

(6) A statement by the taxpayer, or his agent or fiduciary, that he consents to the disclosure or use of such information for the purpose described in subparagraph (3) of this paragraph.

(c) *Illustrations.* The application of this section may be illustrated by the following examples:

Example (1). In order to stimulate the making of loans, a bank advertises that it is in the business of preparing tax returns. A taxpayer goes to the bank to have his tax return prepared. After the return has been completed by the bank, the employee of the bank who obtained the tax return information from the taxpayer explains that the taxpayer owes an additional $400 in taxes and that the bank's loan department may be able to offer the taxpayer a loan to pay the tax due. If the taxpayer decides to accept the opportunity offered to apply for a loan, the bank must first have the taxpayer execute a written consent described in paragraph (b) of this section for the bank to use any of such information which is required in determining whether to make the tax loan.

Example (2). An individual who sells life insurance and shares in a mutual fund is also in the business of preparing tax returns. A taxpayer who has gone to the individual to have his tax return prepared is requested, at the time he picks up his completed tax return, to give his consent to the individual's use of his tax return information in connection with such individual's solicitation of the taxpayer's purchasing a life insurance policy and shares in the mutual fund. Before the individual may use such tax return information as a basis for soliciting such additional business from the taxpayer, the taxpayer must execute separate written consents under paragraph (b) of this section, one authorizing the use of such information as a basis for soliciting the sale of the mutual fund shares and a second authorizing the use of such information as a basis for soliciting the sale of the life insurance.

Example (3). The facts are the same as in example (2) except that the individual does not sell life insurance but does sell shares in several mutual funds. If the request is for the purpose of using the tax return information as a basis for soliciting the sale at one time of shares in mutual funds A and B, only one written consent under paragraph (b) of this section is required of the taxpayer. If, however, the request is for the purpose of using the tax return information as a basis for soliciting the sale of shares in fund A at one time, and the sale of shares in fund B at a later time, two written consents under such paragraph are required of the taxpayer.

§ 301.7701-15 Income tax return preparer.

(a) *In general.* An income tax return preparer is any person who prepares for compensation, or who employs (or engages) one or more persons to prepare for compensation, other than for the person, all or a substantial portion of any return of tax under subtitle A of the Internal Revenue Code of 1954 or any claim for refund of tax under subtitle A of the Internal Revenue Code of 1954.

(1) A person who furnishes to a taxpayer or other preparer sufficient information and advice so that completion of the return or claim for refund is largely a mechanical or clerical matter is considered an income tax return preparer, even though that person does not actually place or review placement of information on the return or claim for refund. See also paragraph (b) of this section.

(2) A person who only gives advice on specific issues of law shall not be considered an income tax return preparer, unless—

(i) The advice is given with respect to events which have occurred at the time the advice is rendered and is not given

with respect to the consequences of contemplated actions; and

(ii) The advice is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund. For example, if a lawyer gives an opinion on a transaction which a corporation has consummated, solely to satisfy an accountant (not at the time a preparer of the corporation's return) who is attempting to determine whether the reserve for taxes set forth in the corporation's financial statement is reasonable, the lawyer shall not be considered a tax return preparer solely by reason of rendering such opinion.

(3) A person may be an income tax return preparer without regard to educational qualifications and professional status requirements.

(4) A person must prepare a return or claim for refund for compensation to be an income tax return preparer. A person who prepares a return or claim for refund for a taxpayer with no explicit or implicit agreement for compensation is not a preparer, even though the person receives a gift or return service or favor.

(5) A person who prepares a return or claim for refund outside the United States is an income tax return preparer, regardless of his nationality, residence, or the locations of his places of business, if the person otherwise satisfies the definition of income tax return preparer. Notwithstanding the provision of § 301.6109-1(g), the person shall secure an employer identification number if he is an employer of another preparer, is a partnership in which one or more of the general partners is a preparer, or is an individual not employed (or engaged) by another preparer. The person shall comply with the provisions of section 1203 of the Tax Reform Act of 1976 and the regulations thereunder.

(6) An official or employee of the Internal Revenue Service performing his official duties is not an income tax return preparer.

(7) The following persons are not income tax return preparers:

(i) Any individual who provides tax assistance under a Volunteer Income Tax Assistance (VITA) program established by the Internal Revenue Service;

(ii) Any organization sponsoring or administering a Volunteer Income Tax Assistance (VITA) program established by the Internal Revenue Service, but only with respect to that sponsorship or administration;

(iii) Any individual who provides tax counseling for the elderly under a program established pursuant to section 163 of the Revenue Act of 1978; and

(iv) Any organization sponsoring or administering a program to provide tax counseling for the elderly established pursuant to section 163 of the Revenue Act of 1978, but only with respect to that sponsorship or administration.

(b) *Substantial preparation.* (1) Only a person (or persons acting in concert) who prepares all or a substantial portion of a return or claim for refund shall be considered to be a preparer (or preparers) of the return or claim for refund. A person who renders advice which is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund, will be regarded as having prepared that entry. Whether a schedule, entry, or other portion of a return or claim for refund is a substantial portion is determined by comparing the length and complexity of, and the tax liability or refund involved in, that portion to the length and complexity of, and the tax liability or refund involved in, the return or claim for refund as a whole.

(2) For purposes of applying the rule of paragraph (b)(1) of this section, if the schedule, entry or other portion of the return or claim for refund involves amounts of gross income, amounts of deductions, or amounts on the basis of which credits are determined which are—

(i) Less than $2,000; or

(ii) Less than $100,000, and also less than 20 percent of the gross income (or adjusted gross income if the taxpayer is an individual) as shown on the return or claim for refund, then the schedule or other portion is not considered to be a substantial portion. If more than one schedule, entry or other portion is involved, they shall be aggregated in applying the rule of this subparagraph (2). Thus, if a person, for an individual taxpayer's return, prepares a schedule for dividend income which totals $1,500 and gives advice making him a preparer of a schedule of medical expenses which results in a deduction for medical expenses of $1,500, the person is not a preparer if the taxpayer's adjusted gross income shown on the return is more than $15,000. This subparagraph shall not apply to a person who prepares all of a return or claim for refund.

(3) A preparer of a return is not considered to be a preparer of another return merely because an entry or entries reported on the return may affect an entry reported on the other return, unless the entry or entries reported on the prepared return are directly reflected on the other return and constitute a substantial portion of the other return. For example, the sole preparer of a partnership return of income or a small business corporation income tax return is considered a preparer of a partner's or a shareholder's return if the entry or entries on the partnership or small business corporation return reportable on the partner's or shareholder's return constitute a substantial portion of the partner's or shareholder's return.

(c) *Return and claim for refund—(1) Return.* A return of tax under subtitle A is a return filed by or on behalf of a taxpayer reporting the liability of the taxpayer for tax under subtitle A. A return of tax under subtitle A also includes an information return filed by or on behalf of a person or entity that is not a taxable entity and which reports information which is or may be reported on the return of a taxpayer of tax under subtitle A.

(i) A return of tax under subtitle A includes an individual or corporation income tax return, a fiduciary income tax return (for a trust or estate), a regulated investment company undistributed capital gains tax return, a return of a charitable remainder trust, a return by a transferor of stock or securities to a foreign corporation, foreign trust, or foreign partnership, a partnership return of income, a small business corporation income tax return, and a DISC return.

(ii) A return of tax under subtitle A does not include an estate tax return, a gift tax return, any other return of excise taxes or income taxes collected at source on wages, an individual or corporation declaration of estimated tax, an application for an extension of time to file an individual or corporation income tax return, or an information statement on Form 990, any Form 1099, or similar form.

(2) *Claim for refund.* A claim for refund of tax under subtitle A includes a claim for credit against any tax under subtitle A.

(d) *Persons who are not preparers.* A person shall not be considered to be a preparer of a return or claim for refund if the person performs only one or more of the following services:

(1) Typing, reproduction, or other mechanical assistance in the preparation of a return or claim for refund.

(2) Preparation of a return or claim for refund of a person, or an officer, a general partner, or employee of a person, by whom the individual is regularly and continuously employed or in which the individual is a general partner.

(3) Preparation of a return or claim for refund for a trust or estate of which the person either is a fiduciary or is an officer, general partner, or employee of the fiduciary.

(4) Preparation of a claim for refund for a taxpayer in response to—

(i) A notice of deficiency issued to the taxpayer; or

(ii) A waiver of restriction after initiation of an audit of the taxpayer or another taxpayer if a determination in the audit of the other taxpayer affects, directly or indirectly, the liability of the taxpayer for tax under subtitle A. For purposes of paragraph (d)(2) of this section, the employee of a corporation owning more than 50 percent of the voting power of another corporation, or the employee of a corporation more than 50 percent of the voting power of which is owned by another corporation, is considered the employee of the other corporation as well. For purposes of paragraph (d)(3) of this section, an estate, guardianship, conservatorship, committee, and any similar arrangement for a taxpayer under a legal disability (such as a minor, an incompetent, or an infirm individual) is considered a trust or estate.

§ 301.7701-16 Other terms.

For a definition of the term "withholding agent" see § 1.1441-7(a). Any other terms that are defined in section 7701 and that are not defined in § 301.7701-1 to 301.7701-15, inclusive, shall, when used in this chapter, have the meanings assigned to them in section 7701.

General Requirements for Substitute Forms

- **Privately Designed and Printed,**
- **Computer-Prepared, and**
- **Computer-Generated**

In many cases, you must get IRS approval if you change IRS forms.

IRS is continuing its efforts to identify and contact tax return preparers who are using substitute forms that impede return processing.

The requirements for most substitute forms are explained in a revenue procedure, which is published annually in the fall and reprinted for public distribution as **Publication 1167**, Substitute Printed, Computer-Prepared and Computer-Generated Tax Forms and Schedules. Highlights of the requirements and permitted changes found in this revenue procedure are below. You can request a copy on Form 3975K.

Revenue procedures for other substitute forms have been issued as publications and may be obtained by using Form 3975K.

You may also use Form 3975K to order **Publication 1192,** Catalogue of Reproducible Forms and Instructions, to obtain copies of reproduction proofs.

Office of Management and Budget (OMB) Requirements for Substitute Forms

The Paperwork Reduction Act of 1980 requires that: (1) OMB approves all Service tax forms, (2) each IRS form contains (in the upper right corner) the OMB approval number and any expiration date, and (3) each IRS form (or its instructions) states why IRS is collecting the information, how it will be used, and whether or not the information is required to be furnished. This information must be provided to every user of any official or substitute tax forms.

All substitute forms must contain in the upper right corner the OMB number and any expiration date that is on the official form.

You must also inform the users of your substitute forms of the Service use and collection requirements stated in the instructions for the official Service form. If you provide your users or customers with the official Internal Revenue Service instructions, page 1 of each form must retain the Paperwork Reduction Act Notice Statement as on the official forms (usually in the lower left corner of the forms). Otherwise, you must duplicate the material in the statement and add the phrase, "For Paperwork Reduction Act Notice, See Separate Instructions."

The OMB approval number, expiration date, and use and collection requirements may be obtained from the official printed form (or its instructions), the reproduction proof (or instructions), or from the Service.

Allowable and Unallowable Changes to and Uses for Tax Forms

Privately Designed and Printed Tax Forms

You can photocopy most tax forms and use them instead of the official ones. Generally, forms that totally conform to the requirements specified in the substitute forms revenue procedure may be privately printed without prior approval.

You can reproduce any current tax form as cut sheets, snap-sets, and marginally-punched, pin-fed forms, so long as you use an official Service version as the master copy. Official versions are supplied by the Service, such as those in Package X, those printed in revenue procedures, reproduction proofs sold by the Service, and over-the-counter forms available at IRS and other governmental public offices or buildings.

You can print and duplicate the substitute "worksheet" versions of Schedules A and B of Form 1040 (see exhibits in the revenue procedure). The Service will accept these substitute schedules instead of the official versions. These schedules serve different purposes. One allows the form to contain state tax information which is blocked out before filing with the Service. The other allows the form to be used singly or as part of a snap-set.

You cannot, without prior Service approval, **change** any Internal Revenue Service tax forms or use your own (non-approved) version, unless specifically permitted by this revenue procedure. Only minor changes are permitted to an official tax form, as OMB approval for IRS use was based on the specific format and content of each form submitted by IRS. Once approved, IRS does not have the authority to change (or to authorize changes to) the official forms.

You cannot adjust any of the graphics on Forms 1040, 1040A and 1040EZ (except in those areas specified in this revenue procedure) without prior approval from the Service.

You cannot use your own version of Schedule A (Form 1040) unless you first get it approved. The Service wants only one Schedule A—either yours or ours; yours needs prior approval from the Service.

You cannot use your own preprinted label on tax returns filed with the Service, unless you fully comply with the exception criteria specified in the revenue procedure.

Computer-Prepared Tax Forms

You can adjust the graphics on certain specified areas of printed Forms 1040 and 1040A (and other forms) to allow for computer-printed or word processor fill-in. Only the areas listed in the revenue procedure may be adjusted without specific prior approval.

You can fill in official Internal Revenue Service supplied forms using computer or word-processing equipment. Internal Revenue Service forms are designed for a vertical spacing of six lines to the inch, with all money amount columns wide enough to allow for the computer printing of ten characters.

Computer-Generated Tax Forms

You can duplicate the approved, computer-generated formats of Schedules 1, A, B, C, D, E, F, R, SE, and Form 3903 (in the revenue procedure) and use them without prior approval.

You cannot computer-generate the TAX RETURNS THEMSELVES (i.e., forms requiring a signature and that establish tax liability; for example, Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.). These forms must be either the official Service forms or those privately preprinted using conventional printing processes, photocopying or similar reproduction processes. The forms may be filled in by a computer, by a word processor, or the like, but the forms themselves must be printed like the Service versions are. First-time users of forms designed using computer graphics must receive prior written approval.

If You Plan To Change or Modify Any Tax Form

IRS **cannot approve** your substitute form until the official form has been published. Please propose your substitute after you have examined the official form.

You should know the Service revenue procedure relating to the official form before you attempt to alter the form to meet your needs. Any alteration of forms must be within the limits acceptable to the Service. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.

Approvals are good for only one calendar year (January through December) or in the case of corporation tax forms (with the exception noted in the revenue procedure), for the remainder of the quarters of the calendar year.

Please Note: *In some cases each new filing season requires a new approval, even if the official form does not change. But see the exception in the revenue procedure.*

Special Enrollment Examination

1988 Questions and Answers Parts I, II, III, & IV

1988 Special Enrollment Examination

The questions in the 1988 examination were directed toward the tasks which enrolled agents must perform to complete and file forms, tax returns, and represent taxpayers before the Internal Revenue Service. Each of the four parts of the examination included true and false and multiple choice questions and covered the following tax areas:

Part I – Individuals.

Part II – Sole Proprietorships and Partnerships.

Part III – Corporations (including S Corporations), Fiduciaries, and Estate and Gift Tax.

Part IV – Ethics, Recordkeeping Procedures, Appeal Procedures, Exempt Organizations, Retirement Plans, Practitioner Penalty Provisions, and Research Materials.

Answers to the questions immediately follow part IV. We have also included an answer worksheet so that you may test yourself and compare your answers with the official answers.

Special Enrollment Examination

Part I

Individuals

Instructions:

The time allotted for this part of the examination is 3 hours. No additional time will be granted.

On your answer sheet in the spaces provided you should enter the following:

1. Sign your name (First, M.I., Last).
2. IRS Regional office number.
3. IRS District office number.
4. Date of this examination.
5. Print your name (Last, F.I., M.I.) in the boxes provided. Immediately below the boxes darken the circle corresponding to each letter you have printed, as in the Sample Name Grid. Darken only one circle in each column below a box in which you have printed a letter. Make no marks in the columns below boxes you have left blank.
6. Enter your candidate number and immediately below, darken the circle corresponding to each number you have entered.

Important:

The answer sheet should not be folded, spindled, stapled, punctured or paper clipped since it will be machine graded.

Read the examination questions carefully. All references are to the Internal Revenue Code as amended through December 31, 1987. Unless otherwise stated all questions relate to the calendar year 1987.

You will be given a No. 2 pencil by the monitor. Darken completely only one circle under the corresponding letter on the answer sheet. In making corrections, erase errors completely. You will be allowed to keep your examination question books after completion of the examination. Scratch paper will be provided, but you may make necessary computations in the question books. Raise your hand to attract the monitor's attention when you need extra supplies or for permission to leave the room.

When you finish the examination, your answer sheet must be turned in to the monitor before leaving the room. The examination will be graded in Washington, D.C., by the Office of Director of Practice, Internal Revenue Service. You will receive formal notification of your examination results on or about December 31, 1988.

General Grading Information:

The questions in this examination have been assigned values of 1 to 3 points. All true or false questions have a value of 1 point each; the multiple choice questions in Section B have a value of 2 points each; and the multiple choice questions in Section C have value of 3 points each.

The examination is graded on the basis of correct answers. If more than one circle is darkened in answering a question, the answer will be considered incorrect.

The Service will include the answers with your formal notification of examination results. Several commercial tax services also publish the examination with their suggested answers. Therefore, you may want to mark your answers in your examination question book and retain it for purposes of your own future comparison.

Part 1

Section A

Questions 1 - 30

The following statements are either true or false. Indicate your selection on the answer sheet by darkening the circle under A for true or under B for false.

1. In 1987, a child who may be claimed as a dependent by another taxpayer, and who has earned income of $400 and unearned income of $200 must file a tax return.

2. A & B are married and timely filed a joint return for 1987. They may change to separate returns within 3 years from the due date of the joint return.

3. The tax shown on Mrs. J's 1987 form 1040, which was for a full year, was $11,000. Mrs. J figures that the tax to be shown on her 1988 income tax return will be $10,000. She estimates that the total amount of income tax that will be withheld from her 1988 income will $9,200. Mrs. J does not need to make estimated tax payments for 1988.

4. Disability payments received from a health or accident plan whose premiums were paid entirely by the employee, are taxable if they total more than 50% of the individual's adjusted gross income.

5. Mr. X worked at Zee Restaurant and received $25 in tips for one month. That same month he also worked at Cheap Restaurant and received $15 in tips. Mr. X must report his tips to both of his employers.

6. A cash basis taxpayer must report interest received on series HH United States Savings Bonds, issued at face value, as income in the year received.

7. During 1982, Mr. P furnished the money to buy U.S. Savings Bonds issued in his name and his brother's name (as co-owners). No election was made to report the interest earned in income each year. During 1987 P's brother cashed the bonds and kept all of the proceeds for his personal use. Mr. P's brother must include the interest earned on the bonds in his gross income for 1987.

8. Mr. X elected to participate in Corporation T's dividend reinvestment plan. Under the plan, Mr. X chose to use his dividends to buy more shares of Corporation T's stock instead of receiving the dividends in cash. Mr. X's dividends for 1987 amounted to $1,700 for which he received 17 shares of stock. Mr. X is not required to include the dividends in taxable income.

9. During 1987, Mr. A, who is 67 years old, received social security benefits of $12,000. This amount was reported to him at year end on a Form SSA-1099. Because he received a Form SSA-1099, A must include this amount as income on his 1987 income tax return.

10. Mr. X, under a divorce instrument, is required to make mortgage payments, pay real estate taxes and insurance premiums on property owned by Mr. X that is being used by his former wife as her residence. Mr. X may deduct these payments as alimony.

11. In order to limit the extent that "front-loaded" payments may qualify as alimony, a recapture rule may apply to the part of the payments made in the first 2 post-separation years that exceed $25,000 a year.

12. In 1986, Mrs. D installed an elevator in her house on the advice of her doctor because of a persisting heart condition. The elevator cost $10,000 and the fair market value of Mrs. D's house increased $5,000 due to the elevator being installed. In 1987, Mrs. D paid $1,000 for repairs to the elevator. The $1,000 is deductible by Mrs. D, as a medical expense for 1987.

13. On August 18, 1987, Mr. Q's original home mortgage had a balance of $30,000. On that date, he took out a $20,000 second mortgage. $5,000 was used for paving his driveway and $15,000 was used to buy a new car. After the improvement, Mr. Q's residence has an adjusted basis of $45,000 and a fair market value of $60,000. All of the interest paid by Mr. Q on his first and second mortgages is fully deductible.

14. Mr. C, as a condition of probation by a federal district court contributed $1,000 to the American Cancer Society. The $1,000 is deductible by C as a charitable contribution.

15. Amounts paid for raffle tickets offered by a church as a fund raiser and appraisal fees paid to determine the fair market value of property given to a qualified charitable organization are deductible as charitable contributions.

16. During 1987, Mr. A had an accident with his 100% personal use auto resulting in $3,000 in damages. His insurance policy does not pay the first $1,000. Because he was afraid of increased insurance premiums, A did not report the accident to his insurance company. A has a $1,000 deductible casualty loss subject to the $100 and 10% AGI limitations.

17. Mr. Good holds a permanent teaching certificate in State A and was employed as a teacher by that state for several years. In August 1987 he moved to State B and was promptly hired by the state to teach school. He is required, however, to complete certain prescribed courses to get a permanent teaching certificate in State B. Mr. Good may deduct his educational expenses for the additional courses to get a permanent teaching certificate in State B.

18. If property is received for services performed, the property's fair market value is includable in the recipient's income. The amount included in income becomes the recipient's basis in the property.

19. The basis of taxable stock dividends received by a shareholder is equal to the par value of the stock plus any income tax that resulted from the inclusion of the dividends in the shareholder's gross income.

20. In January 1984, Ms. A, who is not a dealer in real estate, purchased a tract of land. In September 1986, she subdivided the tract into 8 lots and sold 5 individual lots for a gain of $100,000. In June 1987, she sold the remaining 3 lots for a gain of $60,000. Ms. A had originally planned to build a house on the land, but found a more preferable site. She did not make any improvements on the land during her ownership. A's entire gain on the 1987 sale of lots qualifies for capital gain treatment.

21. During 1987, Bob and Mary Smith, who are both age 60 and are filing a joint return for 1987, sold their home realizing a gain of $121,000. The home had been their principal residence since 1975 and they had never before excluded a gain on the sale of a principal residence. The Smiths may choose to exclude the entire gain from their gross income.

22. If you use the installment method for reporting the gain on a sale, both the selling price and the contract price must be reduced by any unstated interest.

23. The cancellation of an installment obligation is treated as a disposition other than by sale or exchange. The gain or loss is the difference between the basis of the obligation and the fair market value at the time of the cancellation.

24. Nonbusiness bad debts are deducted as short-term capital losses on Schedule D.

25. Mrs. Brown may claim a child and dependent care credit on her 1987 tax return for her daughter, Martha, who is physically handicapped and unable to care for herself. Martha is age 24, has gross income of $2,050, and could be claimed as a dependent by Mrs. Brown except for this income.

26. Sue and Bob Johnson have a babysitter who was sent to them by a babysitting agency. the agency sets the babysitter's fee, requires regular reports from the sitter, and exercises control over the sitter relative to dress and rules of conduct. The Johnsons are required to pay employment taxes and file Form 940 and Form 942 for wages paid to the sitter.

27. Mr. P, age 62, is retired on permanent and total disability. He reached his employer's mandatory retirement age in November 1986, and received taxable disability benefits in 1987. Mr. P qualifies for the credit for the elderly and the permanently and totally disabled.

28. Mr. Z, a citizen of Brazil, was physically present in the United States for 120 days in each of the years of 1985, 1986, and 1987. He has not been admitted to the United States as a lawful permanent resident. However, Mr. Z meets the substantial presence test for 1987 and he would be considered a resident alien of the United States for income tax purposes.

29. During 1987, Abo, a nonresident alien from a nontreaty country, worked outside the U.S. in an overseas office of a U.S. partnership. Abo, who used the calendar year as his tax year, was temporarily present in the United States for 60 days during 1987 performing personal services for the overseas office. He was paid by that office a total gross salary of $2,600 for those services. Abo was not considered engaged in a trade or business in the United States.

30. A nonresident alien individual, engaged in a trade or business in the United States in 1987, must file an income tax return (Form 1040NR) even if the individual's gross income is less than $1,900.

Turn to the next page for Part I, Section B

Part 1

Section B

Questions 31 - 55

The following questions are multiple choice. Select the most appropriate answer and darken the circle under the corresponding letter on the answer sheet.

31. Mrs. C is single, over 65, and cannot be claimed as a dependent by another taxpayer. What amount of gross income is required before she must file an income tax return for 1987?

A. $2,540
B. $3,750
C. $4,900
D. $5,650

32. Mr. and Mrs. P are filing a joint return for 1987. They have two children. Marie, who is 18, earned $2400 from a part-time job. James, who is 22, and attends college as a full-time student, earned $2400 during the summer. Mr. & Mrs. P provide over one-half of their children's support. Mr. P's mother also lives with them, but is self-supporting. How many exemptions can Mr. and Mrs. P claim on their 1987 return?

A. 2
B. 3
C. 4
D. 5

33. For purposes of the dependency support test, all of the following would be included as costs of supporting a dependent except:

A. Fair rental value of dependent's lodging
B. Dependent's food
C. Life insurance premiums on life of dependent
D. Cost of a bed placed in the dependent's bedroom

34. For estimated tax purposes, the calendar year is divided into four payment periods. Which of the following payment periods is incorrect?

A. January 1 through March 31
B. April 1 through June 30
C. June 1 through August 31
D. September 1 through December 31

35. For 1987, all of the following situations will qualify as exceptions to the penalty for underpayment of estimated tax except:

A. All of your 1987 income was from salaries, wages, and tips reported on line 7 of the Form 1040
B. You have less than $500 tax due
C. You had no tax liability for 1986
D. You made estimated tax payments of 80% of the tax shown on your 1987 Form 1040

36. For 1987, all of the following fringe benefits may be excluded from income except:

A. Qualified employee discounts
B. Employer-provided group legal services plan
C. Employer-provided transportation such as a vanpool used for commuting purposes
D. Job related educational expenses paid by the employer

37. Mr. B did not report his tips to his employer as required. He may be subject to a penalty equal to what percent of the employee social security tax that he owes?

A. 75%
B. 50%
C. 25%
D. 10%

38. Mr. B, received $1,880 as interest income and paid an early withdrawal penalty of $991 on a money market account he had at a local bank. Which of the following is the proper way to report these items on his 1987 tax return?

A. Include $889 interest in gross income
B. Include $1,880 interest in gross income
C. Include $1,880 interest in gross income and deduct $991 as an adjustment to income
D. Deduct $991 as an adjustment to income

39. On February 4, 1987, Mr. Baker purchased Corporation L stock for $250. On August 4, 1987, Corporation L made a liquidating distribution of $500 to Mr. Baker. How should Mr. Baker treat the liquidating distribution on his income tax return?

A. $250 short-term capital gain
B. $250 long-term capital gain
C. $250 ordinary income and $250 long-term capital gain
D. $500 ordinary income

40. All of the following statements regarding moving expenses are true except:

A. The distance test is met if the new main job location is at least 35 miles farther from the former home than the old main job location
B. An employee must work full-time for at least 39 weeks during the first 12 months after arriving in the general area of the new job location unless exception applies
C. Moving expenses are deductible by a cash basis taxpayer only in the year paid or incurred regardless of the year of reimbursement
D. An employer is not required to withhold income and social security taxes on moving expense reimbursements that are deductible by the employee

41. Beginning in 1987, an outside salesperson is required to deduct the unreimbursed expenses of performing his job on which of the following:

A. As an adjustment to income on pg. 1 Form 1040
B. Schedule A Form 1040
C. Schedule C Form 1040
D. Form 2106, Employee Business Expenses

42. Mr. B owns and maintains his family home in Reno where he works 20 weeks a year. The rest of the time he works for the same employer in Las Vegas. In Las Vegas, Mr. B eats in restaurants and sleeps in a rooming house. Mr. B's salary is the same whether he is in Reno or Las Vegas. Where is Mr. B's tax home?

A. Reno
B. Las Vegas
C. Reno and Las Vegas
D. Mr. B does not have a tax home

43. Which of the following is not a requirement to be met in order to qualify payments made under a divorce or separation instrument as deductible alimony?

A. The payments must be made by cash, check or money order
B. The payments are for child support
C. The parties do not file a joint return for the year the payments were made
D. The parties are not members of the same household when the payments are made

44. During 1987, A charged $5,000 on his credit card for the medical expenses of his son whom he could claim as a dependent. In the same year, he also paid $1,000 in medical expenses for his wife who died in 1986. What is the amount of A's 1987 deductible medical expenses before the limitation?

A. $-0-
B. $1,000
C. $5,000
D. $6,000

45. Mr. C owns a duplex. He lives in one unit and rents the other unit to an unrelated individual. The two units are equal in size. On July 1, 1987, Mr. C paid the real estate taxes on the duplex for the year in the amount of $1,190. How would Mr. C report the real estate taxes paid on his income tax return for 1987?

A. Schedule-C $595, Schedule-E $595
B. Schedule-A $595, Schedule-E $595
C. Schedule-A $595, Schedule-C $595
D. Schedule-A $1,190

46. Donations to all of the following organizations are deductible as charitable contributions except:

A. A charitable community chest
B. A local chamber of commerce
C. A nonprofit hospital
D. A charitable fund of a domestic fraternal society operating under the lodge system

47. Mr. D's home was completely destroyed by a fire in July 1987. In December 1987, D's insurance company paid him his basis in the home plus $3,000. In order to postpone recognizing the gain, D must acquire replacement property by the end of:

A. July 1989
B. December 1989
C. July 1990
D. December 1990

48. Which of the following miscellaneous deductions is not subject to the 2% of adjusted gross income limit?

A. Clerical help in caring for investments
B. Safe deposit box rental
C. Gambling losses to the extent of gambling winnings
D. Work clothes and uniforms

49. On April 1, 1987, Mr. D purchased stock for investment purposes. In order to qualify for long-term capital gain or loss treatment the property must be held more than:

A. 6 months
B. 9 months
C. 12 months
D. Not applicable since the 60% capital gain deduction was repealed by the Tax Reform Act of 1986

50. During 1987, Sam Johnson sold his personal residence realizing a gain. What is his replacement period for purposes of postponing his gain?

A. Within 1 year before or 2 years after he sold the home
B. Within 18 months before or 18 months after he sold the home
C. Within 1 year before or 18 months after he sold the home
D. Within 2 years before or 2 years after he sold the home

51. During 1985, Mr. F acquired 100 shares of stock in Corporation ABC for $500. During 1987 he sold the stock for $1,000. His adjusted basis in the stock at the time of sale was $500 and he had no other capital gains or losses during the year. What is the character and amount of income to be reported on F's income tax return for 1987?

A. $500 Long-term capital gain
B. $500 Short-term capital gain
C. $500 Ordinary income
D. $200 Long-term capital gain

52. The maximum tax rate on net capital gains for 1987 is:

A. 38.5%
B. 34%
C. 28%
D. 25%

53. Generally, all of the following are requirements for claiming the child and dependent care credit except:

- **A.** You must file Form 1040 or Form 1040A, not 1040EZ
- **B.** You must have made payments for child and dependent care to a nonrelative
- **C.** You must keep up a home that you live in with one or more qualifying persons
- **D.** Your child and dependent care expenses must be incurred to allow you to work or look for work

54. All of the following requirements must be met in order for you to qualify for the earned income credit except:

- **A.** Your principal home must be in the United States
- **B.** You must have a full 12-month tax year
- **C.** Your earned income must exceed 50% of your adjusted gross income
- **D.** You must have earned income during the year

55. During 1987, Sam, a nonresident alien, received wages subject to U.S. income tax withholding. Sam, who uses the calendar year as his tax year, is required to file Form 1040NR by which of the following dates?

- **A.** March 15, 1988
- **B.** April 15, 1988
- **C.** June 15, 1988
- **D.** None of the above

Turn to the next page for Part I, Section C

Part 1

Section C

Questions 56 - 90

The following questions may require some computation. Select the most appropriate answer and darken completely the circle under the corresponding letter on the answer sheet.

56. Mary Jones, a widow whose husband died on September 9, 1986, chose to receive the proceeds for her husband's $150,000 life insurance policy in twenty yearly installments of $10,000. The payments are based on a guaranteed interest rate. How much of each payment is interest income to be included in Ms. Jones' adjusted gross income each year?

A. $1,500
B. $2,500
C. $3,500
D. $4,500

57. Mr. L purchased stock in Corporation O in 1985 for $500. In 1986, Mr. L received a distribution of $200 at a time when Corporation O had no current or accumulated earnings and profits. Mr. L sold his Corporation O stock in 1987 for $700. What is the amount of long-term capital gain to be reported by Mr. L?

A. $-0-
B. $200
C. $400
D. $700

58. Mr. Z owned 200 shares of Corporation K common stock. During 1987, Mr. Z received $600 in cash dividends, 100 additional shares of K's common stock, and rights to purchase 100 more shares. The distributions were not disproportionate and the shareholders were not given an option to receive cash instead of the stock and stock rights. The fair market value of the stock and stock rights was $200 and $100, respectively. What is the amount of income from these distributions that is includable in Mr. Z's income for 1987?

A. $600
B. $700
C. $900
D. $1,000

59. Mr. B received the following payments in connection with his rental property during 1987:

Payment received in December for the first 6 months of 1988	$1,000
Security Deposit to be returned to the tenant upon expiration of the lease in 1990	500
Tenant paid cost of repairs that were B's responsibility	350

What is the amount of gross rental income Mr. B should include on his 1987 Schedule E?

A. $850
B. $1,350
C. $1,500
D. $1,850

60. Ms. Y, who is single, owns several rental properties and actively engages in the management of the properties. For 1987 she received $40,000 in wages from her job. Her net rental loss from the properties in 1987 was $30,000. What is the amount of rental loss that Y may use to offset her other income?

A. $-0-
B. $20,000
C. $25,000
D. $30,000

61. In January 1987, Student T received a $5,000 scholarship for the 1987 spring semester at State University where he is a candidate for a degree. Of the $5,000, $2,000 represents payment for his services as a teaching assistant and $1,000 is for room and board. Assuming all other conditions are met, what amount can T exclude from his income?

A. $5,000
B. $4,000
C. $3,000
D. $2,000

62. Mr. W is 66 years old and single. His income for 1987 consisted of the following:

Taxable pension	$10,000
Taxable interest	2,000
Taxable dividends	5,000
Social Security payments	5,000
Tax exempt interest	7,000

He did not have any adjustments to income. What amount of W's social security benefits is taxable?

A. $-0-
B. $750
C. $1,500
D. $2,000

63. Mr. J was laid off from his job in 1987 and during the year collected $10,000 in unemployment compensation. His other income for the year consisted of the following:

Wages	$12,000
Taxable Interest	1,500
Dividends	3,000
Net Capital Gains	18,000

What is the amount of unemployment compensation that J may exclude from income?

A. $-0-
B. $5,000
C. $5,200
D. $10,000

64. Mr. C was transferred by his employer to another city. He incurred the following expenses and was not reimbursed by his employer.

Pre-Move househunting trip	
Travel	$ 400
Lodging	400
Meals	200
Loss on sale of residence	1,500
Moving personal effects	2,400
Travel to new location	
Driving expense (600 miles@.09)	$54
Lodging	85
Meals	60
Temporary living expenses	
Hotel room	$500
Meals	250

Mr. C's adjusted gross income for 1987 was $50,000. Assuming the time and distance requirements are met, what is the amount of Mr. C's moving expense deduction?

A. $3,087
B. $4,087
C. $4,349
D. $5,587

65. In January 1987, Mr. D, who is self-employed, purchased a new automobile which he uses 100% for business. During 1987, he drove the car 14,000 miles. D also owns another automobile which he uses occasionaly for business but is primarily used for personal purposes. During 1987, he drove the second car 2,000 business miles. The second car is not fully depreciated. What is the amount of D's automobile expense deduction using the standard mileage rate?

A. $3,600
B. $3,485
C. $3,370
D. $3,260

66. During 1987, Mr. C, an employee of ABC corporation, attended an out-of-town business convention and incurred the following business related expenses:

3 nights lodging	$225
Meals	100
Concert tickets for Mr. C and one of his clients	200

Mr. C's employer reimbursed him $225 for lodging and $150 for meals and entertainment. The reimbursement was not included on Mr. C's W-2. What is the amount of the deduction Mr. C may claim on his 1987 Form 1040 without regard to the 2% of adjusted gross income limitation?

A. $-0-
B. $40
C. $50
D. $425

67. During 1987, Ms. S, who is self-employed, paid $2,000 in dues to her country club. She used the club 55% of the time for business purposes, 20% for directly related entertainment, 15% for associated entertainment, and 20% for business meals. What is the amount of dues that Ms. S can deduct as an entertainment expense on her 1987 income tax return?

A. $640
B. $800
C. $1,100
D. $2,000

68. Carol and Bob Smith's real property tax year is the calendar year, with payment due August 1. The tax on their old home, sold on May 6, 1987, was $620 and the tax on their new home, bought May 4, 1987, was $730. What is the amount of the Smith's deductible real estate taxes for 1987?

A. $212
B. $484
C. $531
D. $696

69. In 1987, Martha, a sole proprietor, made interest payments of $1,000 on her personal credit card balance, $2,000 on her business auto loan, and $10,000 on her home mortgage. The proceeds of the mortgage were used to buy the home. What is the total allowable interest deduction on Schedule A of her Form 1040?

A. $10,650
B. $11,950
C. $12,650
D. $13,000

70. During 1987, Mr. K, a C.P.A., made the following donations:

Boy Scouts of America	$1,000
Ten hours of free financial advice provided to Mr. K's local church valued at	500
American Party	300
500 miles driven in his personal auto directly related to services performed for his church (actual cost not available)	

How much may Mr. K deduct as charitable contributions on his Schedule A for 1987?

A. $1,050
B. $1,060
C. $1,375
D. $1,600

71. During 1987, Mr. A had property with an adjusted basis to him of $52,000 condemned by the state. The state paid Mr. A $62,000 for the property. A immediately purchased similar new property for $58,000. Mr. A properly recognized his gain on his income tax return for 1987. What is A's basis in the new property?

A. $48,000
B. $52,000
C. $56,000
D. $58,000

72. Mr. A lives in an area that had been hit by a flood in 1987. Mr. A's house was not damaged. An appraisal of A's property indicates the following:

Cost	$50,000
Improvements	5,000
Fair Market Value December 31, 1987	45,000

In addition, A spent $3,500 for a drainage system around his house because of potential flooding. Without considering any limitations, what is the amount of A's deductible casualty loss for 1987?

A. $-0-
B. $3,500
C. $10,000
D. $13,500

73. In June 1987, Mr. and Mrs. K's home was partly destroyed in a disaster. The area in which their house is located was later declared a disaster area eligible for federal assistance. The K's insurance policy does not cover this type of disaster and they do not expect reimbursement from any other source. The K's chose to claim their disaster loss on their return for calendar year 1986. Based on the following information, what is the amount of their disaster loss deduction?

Adjusted gross income 1986	$40,000
Basis of home (including land)	34,000
Fair market value of home immediately before the disaster	47,500
Fair market value of home immediately after the disaster	15,000
Total loss on furniture (loss on each item was figured separately)	3,000

A. $28,400
B. $31,400
C. $32,400
D. $35,400

74. During 1987, under a qualified written plan for educational assistance, Mr. K's employer paid Local University $9,200 on K's behalf: $7,500 for tuition, books, supplies and lab fees and $1,700 for lodging. What is the amount of assistance that K should include in his gross income for 1987?

A. $9,200
B. $3,950
C. $2,350
D. $1,700

75. Mr. P purchased real property during 1987 and incurred the following costs in connection with his purchase:

Cash paid to the seller for the property	$48,000
Assumed liability for an existing mortgage on the property	12,000
Closing costs and settlement fees	2,000
Real estate taxes paid by Mr. P that were owed by the seller	1,200

What is Mr. P's basis in his property?

A. $48,000
B. $60,000
C. $62,000
D. $63,200

76. Mr. J traded in his truck that had an adjusted basis of $3,500, for a new one costing $12,000. Mr. J paid $7,000 in cash and was allowed $5,000 trade-in value for his old vehicle. What is Mr. J's basis in his new truck?

A. $7,000
B. $8,500
C. $10,500
D. $12,000

77. During 1987, Ms T received a gift of property from her mother. At the time the gift was made, the property had a fair market value of $8,000 and an adjusted basis in her mother's hands of $4,000. Six months after the gift was made, the property had a fair market value of $12,000. No gift tax was paid on the transfer of the property. What is Ms. T's basis in the property?

A. $-0-
B. $4,000
C. $8,000
D. $12,000

78. Mr. Ray inherited farm land from his father who died in 1987. The farm had an adjusted basis in his father's hands of $100,000 and a fair market value on the date of death of $800,000. The estate qualified and elected the alternate valuation date fair market value of $900,000. The estate did not elect to value the property on the basis of its use as a farm. Estate tax attributable to the farm property amounted to $60,000. What is Mr. Ray's basis in the property inherited during 1987?

A. $100,000
B. $800,000
C. $900,000
D. $960,000

79. In 1985, Mr. P bought 100 shares of stock in Corporation X for $20 per share. In 1986, P bought 100 shares of Corporation X stock for $28 per share. In 1987, X declared a 2-for-1 stock split. The fair market value of the stock at the time of the split was $50 per share. What is Mr. P's basis in Corporation X stock?

A. 200 shares @ $10 per share
200 shares @ $14 per share
B. 400 shares @ $12 per share
C. 400 shares @ $50 per share
D. 100 shares @ $20 per share
100 shares @ $28 per share
200 shares @ $50 per share

80. During 1987 Ms. X sold a building she used in her business. Her records on the sale reflect the following information:

Cash received	$200,000
Fair market value of property received by X in addition to cash	40,000
X's mortgage assumed by buyer	34,000
Current real estate taxes assumed by buyer	6,000
Cost of building sold by X	140,000
Capital improvements by X	40,000
Depreciation properly deducted by X	20,000
Selling expenses paid by X	8,000

What is the amount of X's realized gain in 1987?

A. $72,000
B. $78,000
C. $106,000
D. $112,000

81. During 1987, Mr. E, exchanged 100 shares of stock and a piece of real estate that he held for investment for other real estate that he intends to hold for investment. At the time of the exchange, the stock had a fair market value of $1,000 and an adjusted basis to E of $6,000. The old real estate had a fair market value of $38,000 and an adjusted basis to E of $30,000. The new real estate received by E had a fair market value of $40,000 at the time of the exchange. What is the amount of E's recognized gain or (loss) on the exchange?

A. $(5,000) loss
B. $-0-
C. $4,000 gain
D. $5,000 gain

82. For 1987, Mr. H had taxable income of $120,000, excluding exemptions and capital transactions. In 1987, H's capital transactions were as follows:

Gains	$10,000	$20,000
Losses	13,000	24,000

In addition, Mr. H had a $2,200 short-term capital loss carryover from 1986. What is the amount of H's capital loss deduction in 1987 and capital loss carryover to 1988?

Deduction	*Short-Term*	*Long-Term*
A. $-0-	$5,200	$4,000
B. $3,000	$3,000	$ 200
C. $3,000	$-0-	$3,200
D. $3,000	$2,200	$4,000

83. During 1987, A sold stock that cost him $20,000 to his brother B for $15,200. B later sold the stock to an unrelated party for $21,000. What is the amount of A's deductible loss for 1987?

A. $-0-
B. $1,000
C. $4,800
D. $5,800

84. Ben Park's old house had an adjusted basis to him of $45,000. On December 16, 1986, Mr. Parks contracted to sell his home. During October 1986 he paid $1,000 to have the house painted inside and out and $700 for a new water heater. Ben sold the house on January 6, 1987, for $61,400. His selling expenses were $5,000. Within the required time period he bought and began living in a new home that cost $54,400. What is the amount of Mr. Parks' basis in his new home?

A. $33,700
B. $44,700
C. $52,400
D. $53,400

85. Mr. G sold property that had an adjusted basis to him of $4,500 for $9,000 and elected to use the installment method for reporting gain. The buyer agreed to pay G $3,000 at 12% interest over the next 3 years and assume G's existing $6,000 mortgage on the property. G paid selling expenses totalling $500. What is G's gross profit percentage on the sale?

A. 45%
B. 50%
C. 55.5%
D. 100%

86. Mr D sold property that had a basis to him of $19,000. The buyer assumed D's existing mortgage of $15,000 and, in addition, agreed to pay Mr. D $10,000 cash. Mr. D paid selling expenses totaling $1,000. What was the selling price and contract price in this transaction?

Selling Price	*Contract Price*
A. $10,000	$25,000
B. $25,000	10,000
C. $25,000	24,000
D. $25,000	25,000

87. During 1987, Mr. H, who is married filing separately, made the following sales of stock.

100 shares of ABC Co. on 6/1/87 . $1,000
Purchased 2/1/87 for $2,000
100 shares of XYZ Co. on 9/1/87 750
Purchased 4/1/87 for $1,500
100 shares of EFG Co. on 11/1/87 . 1,000
Purchased 9/15/85 for $3,000

What is the amount of H's deductible capital loss for 1987?

A. $-0-
B. $1,500
C. $3,000
D. $3,500

88. Miss J., a single parent, who keeps up a home for herself and her two preschool children, paid work related expenses of $5,200 for child care at a nursery school. Her adjusted gross income is $20,000, the sole source of which is wages. What amount can she claim as a child care credit?

A. $1,152
B. $1,200
C. $1,248
D. $1,300

89. Mr. and Mrs. A, both U.S. citizens, are 67 and 64 years old respectively. Neither is permanently and totally disabled. They filed a joint return for 1987 on which they reported adjusted gross income of $13,400. Together they received $1,200 from social security, all of which was nontaxable. They received no other nontaxable income. What is the amount of the credit for the elderly that Mr. and Mrs. A may claim on their 1987 Form 1040?

A. $-0-
B. $180
C. $255
D. $315

90. Jean Blanc, a citizen and resident of Canada, is a professional hockey player with a U.S. hockey club. Under Jean's contract, he received $68,500 for 165 days of play during 1987. Of the 165 days, 132 days were spent performing services in the United States and 33 playing hockey in Canada. What is the amount to be included in Jean's gross income on his 1987 Form 1040NR?

A. $-0-
B. $34,250
C. $54,800
D. $68,500

END OF PART I

See Separate Instructions (page 97 and 98)

Department of the Treasury
Internal Revenue Service
Form 2587
(Rev. April 1989)

Application for Special Enrollment Examination

MAIL BY DUE DATE—NO EXTENSIONS GRANTED

OMB No. 1545-0949
Expires 1-31-92

In accordance with section 10.4(a), Treasury Department Circular No. 230, I apply for permission to take trhe Special Enrollment Examination.

1. Candidate No.

- Type or print clearly both Parts I and II.
- Do not separate Part I from Part II.
- Mail both parts of this form by the due date with your fee to the Internal Revenue Service, PO Box 85854, Dallas, TX, 75285

2. Signature of Applicant

Signature _____ Date _____

3. Daytime Telephone No. (include area code)

4. Social Security Number

5. Parts to be taken ☐ Part I ☐ Part II ☐ Part III ☐ Part IV ☐ All Parts

6. Name and Address

Name _____

Street _____

City _____ State _____ Zip Code _____

7. Preferred Examination Site

City _____ State _____

8. Location Code (see instructions)

____ - ____ - ____

Before you mail this form, please make sure you have: signed and dated it; checked the boxes showing the parts of the exam you want to take; and included your examination fee (check or money order made payable to Intenal Revenue Service.

Part 1 - National Office Copy

See Separate Instructions (page 97 and 98)

Department of the Treasury
Internal Revenue Service
Form 2587
(Rev. April 1989)

Application for Special Enrollment Examination
RECEIPT OF APPLICATION AND FEE

OMB No. 1545-0949
Expires 1-31-92

In accordance with section 10.4(a), Treasury Department Circular No. 230, I apply for permission to take trhe Special Enrollment Examination.

1. Candidate No.

- Type or print clearly both Parts I and II.
- Do not separate Part I from Part II.
- Mail both parts of this form by the due date with your fee to the Internal Revenue Service, PO Box 85854, Dallas, TX, 75285

2. Signature of Applicant

Signature _____ Date _____

3. Daytime Telephone No. (include area code)

4. Social Security Number

5. Parts to be taken ☐ Part I ☐ Part II ☐ Part III ☐ Part IV ☐ All Parts

6. Name and Address

Name _____

Street _____

City _____ State _____ Zip Code _____

7. Preferred Examination Site

City _____ State _____

8. Location Code (see instructions)

_____ - _____ - _____

Before you mail this form, please make sure you have: signed and dated it; checked the boxes showing the parts of the exam you want to take; and included your examination fee (check or money order made payable to Intenal Revenue Service.

Part 2 - District Office Copy

Back of Part 2

DO NOT sign your name in the spaces provided below until instructed to do so by a monitor at the examination site immediately prior to taking that part of the examination.

Part	Signature
I	
II	
III	
IV	

Paperwork Reduction Act Notice:
We ask for this information to carry out the requirement of 31 Code of Federal Regulations Subtitle A, Part 10, Section 10.4(a). We need this information to identify applicants for the Special Enrollment Examination.

Special Enrollment Examination

Part II

Sole Proprietorships and Partnerships

Instructions

The time allotted for this part of the examination is 3 hours. No additional time will be granted.

On your answer sheet in the spaces provided you should enter the following:

1. Sign your name (First, M.I., Last).
2. IRS Regional office number.
3. IRS District office number.
4. Date of this examination.
5. Print your name (Last, F.I., M.I.) in the boxes provided. Immediately below the boxes darken the circle corresponding to each letter you have printed, as in the Sample Name Grid. Darken only one circle in each column below a box in which you have printed a letter. Make no marks in the columns below boxes you have left blank.
6. Enter your candidate number and immediately below, darken the circle corresponding to each number you have entered.

Important:

The answer sheet should not be folded, spindled, stapled, punctured or paper clipped since it will be machine graded.

Read the examination questions carefully. All references are to the Internal Revenue Code as amended through December 31, 1987. Unless otherwise stated all questions relate to the calendar year 1987.

You will be given a No. 2 pencil by the monitor. Darken completely only one circle under the corresponding letter on the answer sheet. In making corrections, erase errors completely. You will be allowed to keep your examination question books after completion of the examination. Scratch paper will be provided, but you may make necessary computations in the question books. Raise your hand to attract the monitor's attention when you need extra supplies or for permission to leave the room.

When you finish the examination, your answer sheet must be turned in to the monitor before leaving the room. The examination will be graded in Washington, D.C., by the Office of Director of Practice, Internal Revenue Service. You will receive formal notification of your examination results on or about December 31, 1988.

General Grading Information:

The questions in this examination have been assigned values of 1 to 3 points. All true or false questions have a value of 1 point each; the multiple choice questions in Section B have a value of 2 points each; and the multiple choice questions in Section C have value of 3 points each.

The examination is graded on the basis of correct answers. If more than one circle is darkened in answering a question, the answer will be considered incorrect.

The Service will include the answers with your formal notification of examination results. Several commercial tax services also publish the examination with their suggested answers. Therefore, you may want to mark your answers. Therefore, you may want to mark your answers in your examination question book and retain it for purposes of your own future comparison.

Part II

Section A

Questions 1 - 29

The following statements are either true or false. Indicate your selection on the answer sheet by darkening the circle under A for true or under B for false.

1. Generally, you may change your tax year without prior approval of the Internal Revenue Service.

2. An accrual basis taxpayer cannot deduct as business expenses, amounts owed to a related cash basis person until payment is made and the corresponding amount is includible in the gross income of the related person.

3. When inventories are necessary to clearly show income, you must use the accrual method of accounting for sales, purchases, and all other items of income and expense.

DO
by
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Part

I

II

III

IV

4. Whether you use the cash or accrual method of accounting, all prepaid income is generally includable in your gross income in the year received provided it is subject to your free and unrestricted use.

5. Group Life insurance premiums paid by the employer covering the lives of employees who designate their own beneficiaries are not deductible.

6. The cost of renting construction equipment to build a storage facility for use in your business must be capitalized as part of the cost of the building.

7. Costs connected with the issuing and marketing of interests in a partnership are qualifying organizational costs and may be amortized over a period of 60 months or more.

8. All business related travel, entertainment, and meal expenses are subject to the 80% limitation.

9. On July 1, 1987, Mr. K, a calendar year sole proprietor, paid $3,000 in commitment fees to his bank to have business funds made readily available to him over a period of 3 years as needed. K did not borrow any of these funds in 1987. K may deduct $500 of these fees as interest on his schedule C for 1987.

10. Mr. Z, who owns and operates a foreign auto repair shop, pays the premiums on a life insurance policy covering one of his employees. Z is the beneficiary under the policy. Z cannot deduct the premiums as a business expense.

11. Sales tax paid in connection with the purchase of depreciable business property is added to the basis of the property and treated as a part of the property's cost for depreciation purposes.

12. Mr. C considers it necessary to his business to pay kickbacks to the purchasing agents of his customers. The employers of the purchasing agents are unaware of these payments. The kickbacks are in violation of the law in the state in which C resides and the law is generally enforced. Mr. C may deduct the kickbacks as a business expense.

13. If a business activity produced a profit in 1 of the last 5 years, including the current year, it is presumed to be carried on for profit.

14. Section 1245 property includes all real property that is subject to an allowance for depreciation.

15. Ms. B owns a rental apartment house consisting of 4 units. She rents 3 of the units and lives in the 4th. In March 1987, B incurred a deductible casualty loss due to a fire that damaged the entire building. Her casualty loss deduction for the business portion of the property is not reduced by the $100 rule but is subject to the 10% adjusted gross income rule.

16. A co-ownership of property that is maintained and leased does not necessarily constitute a partnership. However, if the co-owners provide services to tenants, a partnership does exist.

17. Certain investing or operating agreement partnerships may be completely excluded from being treated as a partnership for federal income tax purposes. All of the members must choose to be excluded and the partnership has to file a partnership return, Form 1065, by the due date of the return, including extensions, for the first year it wishes to be excluded.

18. A partnership agreement may be modified to change a partner's share of income, deductions, etc. for a particular tax year after the close of that tax year if it is modified not later than the date, not including any extensions of time, for filing the partnership return.

19. The character of a partner's distributive share of a partnership item of income, gain, loss, deduction, or credit that the partner must take into account separately, is determined as if the partner had realized it directly from the same source or incurred it in the same manner as it was realized or incurred by the partnership.

20. A partnership is required to furnish copies of Schedule K-1 (Form 1065) to each of the partners.

21. Mr. B, one of three equal partners, materially participates in the partnership's business. The partnership showed a loss of $15,000 for 1987. Mr. B's adjusted basis in the partnership before considering the 1987 loss was $4,000. The amount of the partnership's loss that Mr. B can claim on his individual income tax return for 1987 is 4,000.

22. For a family member to be recognized as a partner in a partnership where capital is not a material income-producing factor, the family member must contribute substantial or vital services to the partnership.

23. Guaranteed payments made by a partnership to a partner for services or for the use of capital, to the extent they are figured without regard to the income of the partnership, are treated by the partnership in the same way as payments made to a person who is not a partner. This treatment only applies for the purposes of determining gross income and deductible business expenses.

24. A loss deduction is not allowed if there is a loss on a sale or exchange of property between two partnerships in which the same persons own directly or indirectly more than a 50% interest of the capital or profits of each of the partnerships.

25. Generally, gain or loss is not recognized by the partner or partnership when property is contributed to a partnership. This rule applies to a partnership in the process of formation as well as to one that is already formed and operating.

26. All payments made to a retiring partner by his partnership are considered payments for his partnership interest.

27. Payments to a retiring partner in liquidation of his interest that are not considered payments for his interest in partnership property are treated as guaranteed payments if they are not determined by partnership income. The payments are treated as ordinary income by the recipient.

28. During 1981, in dissolution of Partnership XYZ, Partner Z received his pro rata share of inventory items held for sale to customers. The items had an adjusted basis to Z of $50,000. During 1987 Z sold the items for $75,000. At the time of the sale Z was using the items as capital assets. Z's $25,000 gain on the sale is ordinary income.

29. An inactive partner's distributive share of his partnership income is not considered to be self-employment income to the partner for self-employment tax purposes.

Turn to the next page for Part II, Section B

Part II

Section B

Questions 30 - 54

The following questions are multiple choice. Select the most appropriate answer and darken the circle under the corresponding letter on the answer sheet.

30. All of the following accounting periods may be considered proper tax years except:

- **A.** A fiscal year beginning July 1st ending June 30th the following year
- **B.** A 52-53 week year
- **C.** A tax year less than 12 months
- **D.** A fiscal year beginning September 15th ending September 14th the following year

31. Mr. F, a cash basis, calendar year taxpayer, operates a farm and on December 28th, 1987, he sold livestock for $500. He chose to have the stockyard credit his account for $500, with payment to be made to him in full in January 1988. In what year should F include the $500 sale in his income?

- **A.** 1987
- **B.** 1988
- **C.** 1987 or 1988
- **D.** $250 in 1987 and $250 in 1988

32. Which of the following items is not a change in the method of accounting requiring the consent of the IRS:

- **A.** Change from the cash method to accural method or vice versa
- **B.** Change in the method or basis used to value inventories
- **C.** Change in method of figuring depreciation (except certain changes to the straight-line method)
- **D.** An adjustment in the useful life of a depreciable asset

33. The basis of property will be increased by adding to its capital account all of the following except:

- **A.** The cost of extending utility service lines to the property
- **B.** Legal fees, such as the cost of defending and perfecting title
- **C.** Zoning costs
- **D.** Unrecognized gains on involuntary exchanges

34. All of the following inventory practices are acceptable for tax purposes except:

- **A.** Lifo method of identifying inventory
- **B.** Specific cost identification method of inventory valuation
- **C.** Deducting a reserve for price changes in the value of the inventory
- **D.** Perpetual inventory systems

35. All of the following are factors in computing cost of goods sold except:

- **A.** Goods sold but title has not passed to buyer
- **B.** Real estate held for resale by a real estate dealer in the ordinary course of business
- **C.** Freight-in on raw materials purchased for manufacture into a finished product
- **D.** Cost of merchandise contributed to a charitable organization

36. The Uniform Capitalization Rules apply to all of the following business related costs except:

- **A.** Direct material costs
- **B.** Indirect costs
- **C.** Interest on debt to finance the production of real or tangible personal property with a class life of 20 years or more
- **D.** Marketing, selling, advertising and distribution costs

37. Which of the following is not a test in determining whether an employee's pay is deductible?

A. Ordinary and necessary
B. Reasonable
C. Services rendered
D. Control of individual

38. Mr. Y transferred a capital asset to employee Z as compensation. Y paid $25,000 for the asset and at the time of the transfer it had an adjusted basis to Y of $15,000 and a fair market value of $20,000. How should this transaction be handled for income tax purposes?

A. Y reports $15,000 as deductible wages paid
Z reports $15,000 as income from wages
B. Y reports $20,000 as deductible wages paid and recognizes a $5,000 gain
Z reports $20,000 as income from wages
C. Y reports $15,000 as deductible wages paid
Z reports $20,000 as income from wages
D. Y reports $20,000 as deductible wages paid
Z reports $20,000 as income from wages

39. All of the following statements regarding the section 179 deduction are true except:

A. The total cost you may elect to deduct may not exceed $10,000 for 1987
B. The section 179 deduction is reduced if property placed in service during the tax year exceeds $200,000
C. The amount that is not deductible due to the taxable income limitation may be carried over to the subsequent year
D. For passenger automobiles placed in service in 1987, the maximum section 179 deduction and depreciation allowable for 1987 is $3,560.

40. A business auto that is purchased and placed in service after 1986 is classified under the modified accelerated cost recovery system as:

A. 3-year property/with annual limitations
B. 3-year property/without annual limitations
C. 5-year property/with annual limitations
D. 5-year property/without annual limitations

41. Under the modified accelerated cost recovery system (MACRS), residential rental real estate acquired in 1987 is:

A. Given a recovery period of 38 years, 200% declining balance and a half-year convention
B. Given a recovery period of 31.5 years, straight-line method and a mid-month convention
C. Given a recovery period of 27.5 years, straight-line method and a mid-month convention
D. Given a recovery period of 19 years, 150% declining balance method and a half-year convention

42. Mr. Jones, who operates a small tools supply company, guaranteed payment of a $10,000 note for Black Hardware store, one of Mr. Jones' largest clients. Black Hardware later filed for bankruptcy and defaulted on the loan. Mr. Jones made full payment to satisfy the note. Mr. Jones' payment should be considered:

A. A business bad debt
B. A nonbusiness bad debt
C. A gift
D. An investment

43. Mr. F, an accrual basis taxpayer, operates a drug store as a sole proprietor. During 1987, he incurred a bad debt of $4,000 from a sale he made in 1986. Prior to 1987, F used the reserve method for determining his bad debt deduction. The balance in F's bad debt reserve on December 31, 1986 was $8,000. Which of the following reflects the proper handling of the bad debt and bad debt reserve for 1987.

A. $-0- bad debt deduction
$4,000 is the reserve balance at 12/31/87
B. $-0- bad debt deduction
$4,000 ordinary income
C. $4,000 bad debt deduction
$1,000 ordinary income
D. $4,000 bad debt deduction
$2,000 ordinary income

44. Mr. A constructed a factory building for use in his business. The construction started on May 1, 1987 and is to be completed and the building placed in service by October 1, 1988. During the construction period, A incurred and paid interest and real property taxes of $10,000 attributable to the construction. How should the $10,000 be handled for income tax purposes?

A. Amortized over a ten year period starting in 1987
B. Amortized over a ten year period starting in 1988
C. Capitalize the entire $10,000 as part of the building cost
D. Deduct as current operating expenses prorated between 1987 and 1988

45. During 1986, Mr. A, a cash basis taxpayer, was involved in a lawsuit with Corporation D over the amount D owed him for accounting fees. The court decided in A's favor and ordered D to immediately pay him $2,500 without restriction. A received the $2,500 in 1986 and Corporation D immediately appealed the case. In 1987, the appellate court upheld the lower court's decision. Which of the following is the proper way for Mr. A to handle the $2,500 for income tax purposes?

A. Report the $2,500 in 1987 because the case was appealed and he might have had to pay it back
B. Include the $2,500 in income in 1986
C. Include the $2,500 in income in either 1986 or 1987
D. Mr. A does not have to report the $2,500 as income since it resulted from a lawsuit and is nontaxable

46. For 1987 Mr. P had a net operating loss of $32,000. What would be the earliest tax year that he could carry the loss back to?

A. 1982
B. 1983
C. 1984
D. 1985

47. Ms. O, who is single, sold her interest in a small business corporation (section 1244 stock) and incurred a loss of $75,000. What is the character and amount of the loss?

	Ordinary Loss	*Capital Loss*
A.	$75,000	$-0-
B.	$50,000	$25,000
C.	$25,000	$50,000
D.	$-0-	$75,000

48. Which of the following does not qualify as a nontaxable like-kind exchange?

A. The trade of an apartment house for a store building that is subsequently rented out
B. The exchange of a vacant city lot for unimproved farm land
C. The exchange of real estate you own for a real estate lease that runs 30 years or more
D. The exchange of stock of one corporation held for investment for stock of another corporation to be held for investment

49. In May 1987, Mrs. D, an accrual basis taxpayer, had a $10,000 theft loss from inventory items held for sale to customers in the ordinary course of her business. In September 1987, she received a $10,000 reimbursement from her insurance company to cover the loss. Which of the following is a correct method of reporting the loss and reimbursement on D's return?

A. Include the $10,000 in ordinary income. The loss is accounted for in the cost of goods sold
B. Do not report the loss as a separate item
Do not include the $10,000 in ordinary income
C. Include the $10,000 in ordinary income.
Decrease the cost of goods sold by the $100 casualty loss rule
D. Apply the 10% adjusted gross income rule to the loss. The amount of the deductible loss would be the amount of the reimbursement to be included in ordinary income

50. During 1987, Mr. F sold more livestock than usual due to drought conditions. If he wants to make the election to postpone reporting the proceeds from the sale for 1 year, all of the following conditions must be met except:

A. His principal business must be farming
B. He must use the accural method of accounting
C. He must be able to show that, under his usual business practices, the sale would not have occurred this year except for the drought
D. The drought has resulted in the area being designated as eligible for assistance by the U.S. Government

51. In order to avoid an estimated tax penalty a calendar year farmer who owes more than $500 estimated tax and who made no estimated tax payments must file his return and pay all of the tax that is due by:

A. January 15, 1988
B. March 1, 1988
C. March 15, 1988
D. April 15, 1988

52. A single individual may have to pay alternative minimum tax if taxable income for regular tax purposes, plus any adjustments and preference items exceeds:

A. $10,000
B. $20,000
C. $25,000
D. $30,000

53. A truck or truck tractor, together with any semitrailer or trailer customarily used with it may be subject to the heavy vehicle use tax if its taxable gross weight is at least:

A. 50,000 lbs.
B. 55,000 lbs.
C. 60,000 lbs.
D. 65,000 lbs.

54. On September 16, 1987, Mr. C, who is in the long distance moving business, purchased and took delivery of a new truck. The truck was first used on public highways on October 28, 1987. The vehicle is subject to the federal highway use tax on heavy vehicles. By what date must Form 2290, Heavy Vehicle Use Tax Return, be filed:

A. September 30, 1987
B. October 31, 1987
C. November 30, 1987
D. December 31, 1987

Turn to the next page for Part II, Section C

Part II

Section C

Questions 55 - 90

The following questions may require some computation. Select the most appropriate answer and darken completely the circle under the corresponding letter on the answer sheet.

55. Mr. W exchanged a truck that had an adjusted basis to him of $15,000 with an outstanding liability of $2,000 for a new truck having a fair market value of $13,000 and $1,000 in cash. Mr. W's liability was assumed by the other party. What is W's basis in the new truck?

A. $14,000
B. $13,000
C. $12,000
D. $11,000

56. On January 31, 1987 Mr. Y purchased a going business for the lump-sum price of $800,000. The fair market value of the assets Y purchased were as follows:

Certificate of deposit	$ 40,000
Parcel of land	144,000
Office building	360,000
Office equipment	180,000
Office furniture	36,000

What is Mr. Y's basis in the building?

A. $360,000
B. $370,000
C. $378,880
D. $380,000

57. For the calendar year 1987 Ms. K's books and records reflect the following information regarding item X.

Opening inventory:
500 units purchased in July 1986 at $1.00 per unit
300 units purchased in December 1986 at $3.00 per unit
Purchased during 1987
500 units in April at $2.00 per unit
400 units in August at $3.00 per unit
Sold in 1987
1,400 units

What is the cost of goods sold under both the FIFO and LIFO methods of identifying inventory?

	FIFO	*LIFO*
A.	$2,450	$3,000
B.	$2,700	$3,300
C.	$2,850	$3,075
D.	$1,400	$4,200

58. In October 1987, Mrs. X, a calendar year taxpayer, leased a building for 5 years, beginning November 1, 1987, and ending October 31, 1992. Under the terms of the lease, her rent is $24,000 per year. She paid the first year's rent on November 1, 1987. What amount can X deduct as rent expense on her income tax return?

A. $2,000
B. $4,000
C. $12,000
D. $24,000

59. On January 1, 1987, Mr. T purchased and placed in service a passenger automobile that cost $10,000 and qualified as a 100% business vehicle. T did not elect a section 179 deduction but did make the election to use the alternate MACRS method. What is Mr. T's allowable MACRS deduction for 1987?

A. $1,000
B. $2,000
C. $3,334
D. $3,560

60. For 1986, Mr. F, in his first year of operating a business, sustained a net operating loss of $2,000. $5,000 in uncollectible accounts receivable were deducted in arriving at the loss. During 1987, $4,000 of the amount deducted as bad debts in 1986 was recovered. F's 1986 loss was completely absorbed in 1987. What is the amount of the recovery that F must include in his gross income for 1987?

A. $5,000
B. $4,000
C. $3,000
D. $1,000

61. In 1987 Mr. X, sent one of his employees out of state to conduct business with a client. X paid all of the following expenses of the trip:

Air Fare	$1,000
Motel room	2,000
Meals	1,500
Other Transportation	200

Mr. X did not treat the expenses as compensation to the employee. What is the amount X can deduct as travel and transportation expenses for 1987?

A. $3,760
B. $4,000
C. $4,400
D. $4,700

62. Mr. Y paid $10,000 in county club dues for 1987. His records reflect he used the club in the following manner:

Business meals	10%
Directly related entertainment	30%
Personal use	60%

What is the amount of the dues that is deductible by Y as a miscellaneous deduction on Schedule A?

A. $-0-
B. $3,200
C. $4,000
D. $8,000

63. On July 1, 1987, Mr. B, a cash basis, calendar year, self-employed custom furniture builder, took out a $100,000 10-year loan at 10% interest to construct a shop building having a useful life of 25 years. In order to get the loan, Mr. B had to pay the lender "points" (loan origination fee) of $2,500. How much of the $2,500 can Mr. B deduct as interest expense on his Schedule C for 1987?

A. $100
B. $125
C. $250
D. $2,500

64. Mr. and Mrs. B operate a business as a calendar year cash basis partnership. During 1987, the partnership paid insurance premiums for the following coverage:

Workers compensation insurance on behalf of the partners	$ 650
Malpractice insurance covering a professional's personal liability for negligence resulting in damages to a client	1,000
A policy that would pay for the partners' lost earnings due to a disability	400
Fire insurance on their business building building effective October 1, 1987, and ending September 30, 1989	1,200

What is the amount of the allowable 1987 business insurance deduction?

A. $1,150
B. $2,050
C. $2,250
D. $2,400

65. During 1987, Mr. C had the following expenditures relating to his rental property:

Local assessment for repair of sidewalk	$ 200
Property tax on rental house #1	900
Mr. C's portion of property tax paid on rental house #2 sold in 1987	350
Local assessment for connection to newly constructed sewage system	1200

What is the amount of the above expenditures that must be capitalized?

A. $-0-
B. $550
C. $1,200
D. $1,400

66. What is the amount of Mr. G's net operating loss for 1987, based on the following information?

Net loss from business (sales of $100,000 less expenses of $120,000)	$(20,000)
Salary from part-time employment	9,000
Interest income from savings	1,000
Net long-term capital gain from sale of business property	5,000
Net short-term capital loss from sale of stock	(4,000)
Personal exemption	1,900
Standard deduction	2,540
1986 net-operating loss carryover	(2,000)

A. $10,000
B. $11,000
C. $12,900
D. $14,900

67. In 1987, Ms. B sold a business asset that had an adjusted basis to her of $55,000 for $80,000 cash plus art work having a fair market value of $30,000. The buyer assumed Ms. B's $15,000 loan on the business asset. Ms. B paid $6,000 in selling expenses. What is the amount of Ms. B's gain on the sale?

A. $30,000
B. $45,000
C. $64,000
D. $70,000

68. Mr. P exchanged real estate held for investment, which had an adjusted basis to him of $90,000, for other investment real estate. The real estate P received had a fair market value of $110,000 at the time of the transfer. Mr. P also received $15,000 in cash. What is the amount of Mr. P's taxable gain?

A. $-0-
B. $15,000
C. $20,000
D. $35,000

69. In December 1987, Mr. J sold a machine used in his business that had an adjusted basis to him of $2,000 for $6,000. J bought the machine in January 1978 for $10,000. How much of Mr. J's gain on the sale of the machine is treated as ordinary income under Section 1245?

A. $-0-
B. $2,000
C. $4,000
D. $8,000

70. Mr. R made a gift of section 1250 property to his son. R had properly claimed depreciation totaling $3,000 of which $750 was additional depreciation. For the year in which the gift was made, the son properly claimed $1,000 in depreciation of which $250 was additional depreciation. On January 2 of the following year the son sold the property for a gain of $2,000. What is the amount of the son's section 1250 gain?

A. -0-
B. $250
C. $750
D. $1,000

71. Mr. H helped Mr. Y build a barn and received a cow in payment for the work he performed. It would have cost Mr. Y $1,400 if he paid someone to do the work performed by Mr. H. The cow cost Mr. Y $2,100 but had a fair market value of $1,300 at the time of the transfer. What would be the amount Mr. H reports as ordinary income from this bartering transaction?

A. $800
B. $1,300
C. $1,400
D. $2,100

72. Mr. A has a 20% interest in a partnership and he materially participates in the partnerships's business. Mr. A's adjusted basis in the partnership was $10,000 at the beginning of 1987. During 1987, the partnership borrowed $160,000 to purchase equipment and pay off an existing note with a balance of $100,000. All of the partners are personally liable for all partnership debts. The partnership sustained a $300,000 loss in 1987. What amount can Mr. A claim as a loss from the partnership on his 1987 individual return?

A. $10,000
B. $22,000
C. $42,000
D. $60,000

73. Mr. A gave 50% of his business to his son B. The partnership had a profit of $100,000 for the year and capital is a material income producing factor. A performed services worth $25,000 as reasonable compensation, and B performed no services. What is the maximum amount of income B can report from the partnership for the year?

A. $18,750
B. $37,500
C. $50,000
D. $25,000

74. Mr. B acquired a 20% interest in a partnership by contributing property that had an adjusted basis to him of $8,000 and was subject to a $12,000 mortgage. Payment of the mortgage was assumed by the partnership. What is the amount of the capital gain that Mr. B has incurred?

A. $-0-
B. $1,600
C. $3,200
D. $4,000

75. On January 1, 1985, Mr. X contributed 1,000 shares of Corporation M stock that he had held for investment, to his partnership XYZ which is a dealer in securities. The stock had an adjusted basis to X of $10,000 and a fair market value at the time of the transfer of $7,000. On June 20, 1987, the partnership sold the stock for $2,000. What is the amount and character of the partnership's loss that is deductible by the partners?

A. $3,000 capital loss
$5,000 ordinary loss
B. $5,000 capital loss
C. $8,000 ordinary loss
D. $8,000 capital loss

76. Mr. J had an adjusted basis of $10,000 in a partnership at the beginning of 1987. Both Mr. J and the partnership are calendar year taxpayers. During 1987 J received $12,000 in guaranteed payments for services he performed. The payments were made without regard to partnership income. During the same year, Mr. J withdrew $4,000 in cash from the partnership and was relieved of a partnership liability of which his share amounted to $2,000. Partnership income for 1987 was zero. What is Mr. J's basis in the partnership should he sell his interest January 1, 1988?

A. $4,000
B. $8,000
C. $16,000
D. $20,000

77. Partnership LIFE's profits and losses are shared equally between the 4 partners. The adjusted basis of Partner E's interest in the partnership on December 31, 1986 was $25,000. On January 2, 1987, Partner E withdrew $10,000 cash. The partnership reported $200,000 as ordinary income on its 1987 partnership return. In addition, $5,000 for qualified travel, meals, and entertainment was shown on a separate attachment to E's Schedule K-1 of Form 1065. Due to the limitation, $1,000 of the $5,000 is unallowable as a deduction. What is the amount of E's basis in the partnership on December 31, 1987?

A. $60,000
B. $61,000
C. $65,000
D. $71,000

78. Partnership AX made a nonliquidating distribution to partner X of $8,000 cash and a parcel of land that had an adjusted basis to the partnership of $16,000 and a fair market value at the time of the distribution of $40,000. X's adjusted basis in the partnership before the distribution was $20,000. What is X's basis in the land received?

A. $40,000
B. $20,000
C. $16,000
D. $12,000

79. Mr. C's adjusted basis in ABC Partnership is $60,000. In complete liquidation of his interest he received $20,000 cash, inventory items that had an adjusted basis to the partnership of $24,000 and two parcels of land having adjusted bases to the partnership of $24,000 and $8,000 respectively. What is C's basis in each of the two parcels of land?

A. $24,000 and $8,000
B. $18,000 and $6,000
C. $12,000 and $4,000
D. $6,000 and $2,000

80. Mrs. C is a limited partner in ABC Partnership. The adjusted basis of her partnership interest at the end of the current year is zero. Mrs. C's share of the partnership liabilities is $15,000, and her share of the ordinary income potential in partnership depreciable property is $5,000. Mrs. C sold her partnership interest for $10,000 cash. What is the amount and character of Mrs. C's gain?

A. $20,000 capital gain
B. $5,000 ordinary income and $15,000 capital gain
C. $5,000 ordinary income and $20,000 capital gain
D. $5,000 ordinary income and $25,000 capital gain

81. Mr. P's partnership interest in PAL Partnership had an adjusted basis of $20,000. This included his $15,000 share of the partnership's liabilities for which neither he, the other partners, nor the partnership had assumed personal liability. The partnership has no other liabilities, unrealized receivables, or substantially appreciated inventory items. Mr. P sold his interest in the partnership for $9,000 cash and was relieved of his share of the partnership's liabilities. What is the amount of P's capital gain or loss?

A. $-0-
B. $4,000 gain
C. $5,000 gain
D. $(11,000) loss

82. The adjusted basis of Mr. D's partnership interest is $10,000. Mr. D received a nonliquidating distribution of $8,000 cash and land that had a basis to the partnership of $3,000 and a fair market value of $4,000. What is the amount of gain or loss to be recognized by Mr. D?

A. $-0-
B. $(2,000) loss
C. $1,000 gain
D. $2,000 gain

83. On January 2, 1987, Mr. B became a one-third partner in ABC partnership by contributing $10,000 cash. The adjusted basis of B's partnership interest is $22,000, which includes his one-third share of the partnership liabilities for which neither he, the other partners, nor the partnership had assumed any personal liability. The partnership reported a $30,000 ordinary loss for 1987, and each partner properly claimed his distributive share. The partnership has no other liabilities, unrealized receivables, or substantially appreciated inventory items. On December 31, 1987, Mr. B withdrew from the partnership and was relieved of his share of the partnership's liabilities. What is the amount and character of B's gain or loss?

A. $(10,000) capital loss
B. $-0-
C. $12,000 ordinary loss
D. $12,000 capital gain

84. Ms. D became a partner in DEF Partnership by contributing $20,000 when it was formed. On 12/31/87 her basis was $40,000 which included her share of partnership liabilities of $30,000 for which neither Ms. D, the other partners nor the partnership had assumed any personal liability. The partnership had no other liabilities and no unrealized receivables or substantially appreciated inventory items. D sold her interest in the partnership for $20,000 in cash. What is D's gain on the sale of her partnership interest?

A. $5,000
B. $10,000
C. $20,000
D. $30,000

85. Ms. Z has a general business credit of $48,000 available for 1987. Her income tax as adjusted is $53,000. What is the amount of the general tax credit that Ms. Z can take for 1987?

A. $25,000
B. $46,000
C. $48,000
D. $53,000

86. In May 1986 Mr. F took delivery of two new machines that he had signed a binding contract for in 1985. The machines cost $6,000 and $5,000 respectively and were 5-year recovery property. Each machine was placed in service when it was delivered. No section 179 deduction was taken on either machine. F's 1986 tax return showed an investment credit of $1,100 against income tax, as adjusted, of $1,500. The machine which cost $6,000 was sold on December 10, 1987. What is the amount of investment credit that should be recaptured in 1987?

A. $400
B. $480
C. $500
D. $600

87. During 1987, Mrs. W hired an economically disadvantaged Vietnam-era veteran for 99 days to perform duties related to her business. Mrs. W paid the employee a total of $6,500 during 1987. What is the amount Mrs. W may claim as a jobs credit?

A. $-0-
B. $2,400
C. $2,600
D. $3,000

88. In 1987, Mr. P, to improve his business, had contract research expenses of $20,000 and in-house research expenses of $110,000. The average of these expenses during the prior 3 years was $50,000. Mr. P's income tax liability for 1987 was $70,000. He did not have any targeted jobs credit for 1987. What amount may Mr. P claim as a research credit?

A. $13,000
B. $12,300
C. $26,000
D. $70,000

89. During 1987, Mr. J received income from the following sources:

Fees received for services as a corporate director	$ 500
Guaranteed payments for services performed for his partnership	1,500
Unemployment compensation	2,500
Distributive share of income from an investment club partnership that buys stock and collects dividends	4,000

What is the amount of J's self-employment income for 1987?

A. $2,000
B. $4,500
C. $6,000
D. $8,500

90. Ms. K is a single taxpayer. What is her alternative minimum tax for 1987 based on the following information?

Taxable income	$41,500
Regular income tax before credits	10,388
The following adjustments or preferences:	
Miscellaneous itemized deductions after taking account of the 2% floor from Schedule A	2,500
Taxes from Schedule A	3,500
Depreciation adjustment for property placed in service after 1986	1,500
Passive activity loss adjustment	10,000
Incentive stock option preference item	5,000
Appreciated property charitable deduction preference item	7,500
Depletion preference item	15,000

A. $-0-
B. $912
C. $1,477
D. $3,577

END OF PART II

Special Enrollment Examination

Part III

Corporations (including S Corporations), Fiduciaries, and Estate and Gift Tax

Instructions:

The time allotted for this part of the examination is 3 hours. No additional time will be granted.

On your answer sheet in the spaces provided you should enter the following:

1. Sign your name (First, M.I., Last).
2. IRS Regional office number.
3. IRS District office number.
4. Date of this examination.
5. Print your name (Last, F.I., M.I.) in the boxes provided. Immediately below the boxes darken the circle corresponding to each letter you have printed, as in the Sample Name Grid. Darken only one circle in each column below a box in which you have printed a letter. Make no marks in the columns below boxes you have left blank.
6. Enter your candidate number and immediately below, darken the circle corresponding to each number you have entered.

Important:

The answer sheet should not be folded, spindled, stapled, punctured or paper clipped since it will be machine graded.

Read the examination questions carefully. All references are to the Internal Revenue Code as amended through December 31, 1987. Unless otherwise stated all questions relate to the calendar year 1987.

You will be given a No. 2 pencil by the monitor. Darken completely only one circle under the corresponding letter on the answer sheet. In making corrections, erase errors completely. You will be allowed to keep your examination question books after completion of the examination. Scratch paper will be provided, but you may make necessary computation in the question books. Raise your hand to attract the monitor's attention when you need extra supplies or for permission to leave the room.

When you finish the examination, your answer sheet must be turned in to the monitor before leaving the room. The examination will be graded in Washington, D.C., by the Office of Director of Practice, Internal Revenue Service. you will receive formal notification of your examination results on or about December 31, 1988.

General Grading Information:

The questions in this examination have been assigned values of 1 to 3 points. All true or false questions have a value of 1 point each; the multiple choice questions in Section B have a value of 2 points each; and the multiple choice questions in Section C have value of 3 points each.

The examination is graded on the basis of correct answers. If more than one circle is darkened in answering a question, the answer will be considered incorrect.

The Service will include the answers with your formal notification of examination results. Several commercial tax services also publish the examination with their suggested answers. Therefore, you may want to mark your answers in your examination question book and retain it for purposes of your own future comparison.

Part III

Section A

Questions 1 - 41

The following statements are either true or false. Indicate your selection on the answer sheet by darkening the circle under A for true or under B for false.

1. A corporation, for federal income tax purposes, includes joint stock companies and associations.

2. Trusts and partnerships that actually operate as corporations or associations are considered corporations for federal income tax purposes.

3. A corporation that has not dissolved must file an income tax return even if it has ceased doing business and has disposed of all its assets except for a small sum of cash retained to pay state taxes to keep its corporate charter.

4. A corporation with no assets is not required to file an income tax return after it stops doing business and dissolves. This is true even if it is treated as a corporation under state law for limited purposes connected with winding up its affairs.

5. A personal service corporation must use as its tax year the tax year of its primary shareholder.

6. One of the requirements that must be met for a corporation to file Form 1120-A is that the corporation's total income must be under $100,000.

7. A calendar year corporation with an unpaid income tax liability for 1987 of $10,000 submitted a timely application Form 7004 for extension of time for filing its 1987 return with no payment. If the corporation files its return with payment in full on September 15, 1988, no failure to pay penalty will be applied.

8. A corporation may have to pay the alternative minimum tax if taxable income for regular tax purposes, plus any of the adjustments and preference items that apply, total more than $40,000.

9. Corporation Z's estimated tax payments exceeded its income tax liability by 5% which amounted to $2,000. Corporation Z may apply for a quick refund for overpayment of estimated tax.

10. No gain or loss is recognized by the transferors or the corporation if there is a transfer of money or property by individuals to the corporation solely in exchange for stock of that corporation and immediately after the exchange the transferors, as a group, own at least 80% of the total combined voting power of all classes of voting stock and at least 80% of the total number of shares of all other classes of the corporation's stock.

11. Organizational costs of a corporation are those costs that are incident to the creation of the corporation and must be amortized or capitalized. All of the following qualify as organizational costs.

- Legal expenses for drafting the charter & bylaws
- Expenses of organizational meetings of directors and shareholders
- Fees paid to a state for incorporation
- Expenses of temporary directors

12. If a corporation wants to amortize organizational expenses, it must choose to do so when it files its return for the first tax year in which it is actively engaged in business. The choice must be made not later than the due date (including extensions) of the return for that tax year. The corporation does this by attaching a statement to the return indicating that it is choosing to amortize these expenses.

13. Any charitable contributions made during the year by a corporation that exceed the 10% limit may, subject to certain limitations, be carried over to each of the following 7 years.

14. Capital losses that cannot be used by a corporation in the current year are carried back to the 3 years preceding the year of loss and, if not completely absorbed, are then carried over for up to 5 years following the loss year.

15. During 1987 Mr. W sold a building he bought in 1980 and had been using in his business to Corporation X for use in its business. As a result, W had a recognized gain of $20,000. Mr. W owns 51% of X's only class of stock. For income tax purposes, the gain recognized by Mr. W is treated as a capital gain.

16. When there are two or more capital loss carryovers, the loss from the earliest year is applied first to reduce the current year's net capital gains; then, the next carryover is applied until all carryovers are absorbed.

17. When figuring modified taxable income for a corporation's NOL deduction, the computation to determine the deduction for charitable contributions is the same whether it is for the carryback or carryover year.

18. If a corporation carries two or more net operating losses to the same year, it must deduct them one at a time, in the order in which they were incurred.

19. A corporation must deduct as much of its net operating loss as possible. Any of the NOL that is left over after modified taxable income is reduced to zero can be carried over to the next year.

20. The amount of a distribution received by a corporate shareholder is the money received plus the greater of:

1. The fair market value, on the distribution date, of other property received, or
2. The adjusted basis of other property, in the hands of the distributing corporation, increased by the gain recognized by the distributing corporation in distributing the property.

21. The amount of a distribution received by a noncorporate shareholder is any money received plus the distributing corporation's adjusted basis in other property received.

22. A distribution to shareholders of stock or rights to acquire stock in the distributing corporation is included in the shareholder's gross income if it is a distribution in lieu of money and the corporation has sufficient earnings and profits for the distribution to be considered a dividend.

23. A corporation that is in the process of dissolution may, after filing its tax returns, submit a written request for prompt assessment of any corporation tax liabilities.

24. The effect of a request for prompt assessment by a corporation in the process of dissolution is that the Internal Revenue Service will immediately collect the amount of tax liabilities owed by the corporation.

25. Corporation Z has only one class of stock outstanding, composed of 300 shares which are owned by three unrelated parties. Mr. K and Mrs. Y each own 125 shares and Mrs. P 50 shares. If Z makes a cash redemption of 75 shares from both Mr. K and Mrs. Y, and 25 shares from Mrs. P the proceeds will qualify for capital gain or loss treatment by the shareholders as a disproportionate distribution.

26. A corporation that wants to be treated as an S corporation must file a properly completed Form 2553, Election by a Small Business Corporation, at any time during the tax year prior to the year to which the choice will apply or by the 15th day of the 3rd month of the tax year to which the choice applies.

27. An S corporation will not be subject to the tax on excess net passive income if it has been an S corporation from the date of its incorporation and has no subchapter C earnings and profits from a corporate acquisition.

28. If an S corporation distributes appreciated property, the S corporation will be treated as if it had sold the property to the distributee shareholders at fair market value.

29. Only those S corporation shareholders holding stock on the last day of the tax year may claim their distributive shares of corporate losses and deductions on their individual tax returns.

30. If a decedent used the cash method of accounting, the decedent's final return should show only the items of income that the decedent actually or constructively received before death.

31. Ms. B died September 30, 1987. In January 1988, B's executor received a Form 1099 for B covering the entire year 1987. Included was income earned after B's death that belonged to one of her beneficiaries. All of the income shown on the 1099 would be included in B's adjusted gross income for 1987.

32. An estate, or other recipient, that acquires property from a decedent and sells or otherwise disposes of the property within 6 months of the decedent's death is considered to have held the property for the required long-term holding period of more than 6 months.

33. In December 1984, Ms. J assigned all rights under a life insurance policy in her name to another person. She did not receive any money or something of equal value in return. Ms. J was required to file a gift tax return. Ms. J died in February 1987. The proceeds of the life insurance policy are included in Ms. J's gross estate.

34. The election to use the alternate valuation method does not change the rule that the gross estate includes property that the decedent owned or had an interest in on the date of death.

35. For tax years beginning after 1987, estates with tax years ending 2 or more years after the date of the decedent's death must pay estimated tax in the same manner as individuals.

36. If all of the assets of an estate have been distributed before all taxes have been paid, the beneficiary may be liable for the tax due and unpaid to the extent of the beneficiary's distributive share of the estate that was received.

37. Mr. J made a $21,000 payment directly to an educational organization for the tuition of another individual. This is considered a qualified transfer and does not require the donor to file a gift tax return.

38. A gift made by a person to someone other than a spouse may be considered as made one-half by each spouse. This is known as gift splitting, and if the spouses consent to gift splitting, all qualifying gifts made during the year must be split.

39. A corporation does not have to withhold tax on dividends it paid to a shareholder whose address is in the United States unless there are facts and circumstances that clearly indicate that the shareholder is a nonresident alien or a foreign partnership or corporation.

40. Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, is due by March 15 of the year following the tax year even if there was no withholding because of a specific withholding exemption.

41. Income tax withheld on a foreign corporation must be deposited by the withholding agent with an authorized financial institution or a Federal Reserve Bank using Form 8109, Federal Tax Deposit Coupon.

Turn to the next page for Part III, Section B

Part III

Section B

Questions 42 - 71

The following questions are multiple choice. Select the most appropriate answer and darken the circle under the corresponding letter on the answer sheet.

42. Whether an unincorporated organization should be treated as a corporation for federal income tax purposes is determined by considering all of the following characteristics except:

A. Continuity of Life
B. Limited Liability
C. Equity capital
D. Centralization of management

43. If an S corporation is required to file a federal tax return, Form 1120S, and there is tax due, the amount must be paid in full by:

A. 2 1/2 months after the end of the tax year
B. 3 1/2 months after the end of the tax year
C. 4 1/2 months after the end of the tax year
D. Due with the return when filed if properly extended

44. A corporation may receive an automatic extention of time for filing its federal income tax return by filing a Form 7004 by the due date of the corporation's return. This will extend the time for filing:

A. 3 months
B. 6 months
C. 9 months
D. 3 months and 15 days

45. All of the following statements about the corporate tax rates for tax years beginning on or after July 1, 1987 are true except:

A. Corporate taxable income is subject to tax under a three-bracket graduated rate system
B. The tax rate is 15% of the first $50,000 of taxable income
C. The tax rate is 30% if taxable income is over $50,000 but not over $75,000
D. A fiscal year corporation that has a tax year beginning in 1986 and ending after June 30, 1987, uses a blend of the old and the new rates.

46. The Smith Corporation is a calendar year taxpayer that first meets the requirement for making estimated tax deposits on April 8. By which date must they begin making estimated tax installment deposits?

A. April 15
B. June 15
C. September 15
D. December 15

47. For 1987, subject to certain limitations, the corporate "Dividends-Received Deduction" for dividends received from taxable domestic corporations is generally:

A. 75%
B. 80%
C. 85%
D. 90%

48. A corporation may deduct capital losses only to the extent of:

A. $3,000
B. Taxable income before any capital loss deduction
C. Net Investment Income
D. Its capital gains

49. All of the following rules pertaining to the computation of a corporation's net operating loss (NOL) apply except:

A. You cannot deduct any NOL carryback or carryover from other years to determine the current year NOL
B. The current year NOL must first be carried back and if it cannot be absorbed, only then may it be carried forward
C. The deduction for dividends paid on certain public utility preferred stock is not limited to taxable income
D. The deduction for dividends received is not limited to a percentage of the corporation's taxable income

50. Corporation A, a calendar year corporation, had a net operating loss of $100,000 for the year 1986. A made a proper election to forgo the carryback period. In 1987, Corporation A deducted $90,000 of the 1986 NOL. Corporation A will lose the remaining $10,000 deduction if it is not taken by the end of what taxable year?

A. 1991
B. 1992
C. 1997
D. 2001

51. A corporation is required to file a Form 1099-DIV for each stockholder to whom it pays gross dividends of:

A. $10 or more
B. $100 or more
C. $200 or more
D. $1,000 or more

52. Within how many days after the adoption of a resolution or plan (including any amendment or supplements to it) for the dissolution of a corporation or its complete or partial liquidation, must the corporation file information return Form 966, Corporate Dissolution or Liquidation, with the Internal Revenue Service Center with which the corporation is required to file its income tax return:

A. 10 days
B. 20 days
C. 30 days
D. 40 days

53. A corporation making any distribution in liquidation must file Form 1099-DIV in each calendar year of the liquidation for each shareholder to whom it makes distributions of $600 or more by which of the following dates in the year following the close of the calendar year in which the distribution was made?

A. January 15
B. January 31
C. February 15
D. Last day of February

54. In 1984, Mr. P purchased stock for $1,000. In 1986 he received a return of capital of $800 and reduced the basis of his stock by that amount. In 1987, he received another return of capital which amounted to $300, which reduced the basis of his stock to zero. He would report the $100 that was in excess of his basis as:

A. Interest
B. Long-term capital gain
C. Dividend
D. Short-term capital gain

55. To qualify for S corporation status, a corporation must meet 6 requirements. Which of the following is not a requirement?

A. It must be a "domestic" corporation
B. It must have only one class of stock
C. It must have no more than 30 share holders
D. It must have shareholders that are citizens or residents of the United States

56. Which of the following deductions may be claimed by an S corporation in computing its ordinary income or loss from business?

A. Net operating loss
B. Business bad debt
C. Depletion
D. Charitable contributions

57. An S corporation made an early disposition of an asset on which it had claimed the investment tax credit on its corporate income tax return before it became an S corporation. What is the effect of this early disposition?

A. The shareholders who owned the corporation at the time the credit was claimed are liable for the recapture tax
B. The recapture tax is the liability of the existing S corporation shareholders
C. The S corporation, and not its shareholders, is liable for the recapture tax
D. Neither the S corporation nor its shareholders are liable for tax resulting from the early disposition

58. Which two of the following situations will cause an S corporation status to be terminated?

1. Shareholders who collectively own 50% of the outstanding shares consent to the revocation
2. Transferring stock in the S corporation to a partnership
3. The S corporation has earnings and profits for 2 consecutive years and its passive investment income for both years is more than 25% of gross receipts.
4. Creating a class of stock other than the voting and nonvoting common stock

A. 1 & 2
B. 2 & 3
C. 3 & 4
D. 2 & 4

59. At-risk rules are applied to limit the amount of loss that may be passed through to an S corporation shareholder. Which of the following does not affect the at-risk limit?

A. A cash contribution to the S corporation
B. The adjusted basis of other property contributed to the S corporation
C. Amounts borrowed for use in the S corporation for which the shareholder is personally liable
D. The fair market value of appreciated real estate contributed to the S corporation

60. If three of the following conditions are present, an S corporation may be liable for a capital gains tax. Which one is the exception?

A. Its net long term capital gains exceed net short-term capital losses by more than $25,000
B. Taxable income is more than $25,000
C. Net investment expenses exceed 20% of taxable income
D. Net long-term capital gains are more than 50% of the corporation's taxable income

61. All of the following factors serve to determine whether an S corporation may be subject to the tax on excess net passive income except:

A. The S corporation has earnings and profits at the end of the tax year
B. Passive investment income is more than 25% of its gross receipts
C. More than 50% of loans payable are not at-risk
D. The S corporation has been an S corporation from the date of its incorporation

62. A domestic estate that has only U.S. citizens as beneficiaries must file a Form 1041 if the gross income of the estate is at least:

A. $500
B. $600
C. $1900
D. $2500

63. Which of the following statements relating to the charitable contribution deduction on an income tax return of an estate is true?

A. The AGI limitation applies the same as for individuals
B. To be deductible by an estate, a specific provision for the contribution must be in the will of the decedent
C. If there is no will, a contribution deduction will be allowed if all beneficiaries agree to the contribution
D. A credit for political contributions is allowable

64. Mr. G died in 1986 leaving all of his property to his two children. For 1987, G's estate had $16,000 in distributable net income. The executor of G's estate, who has full discretion as to when income is to be distributed, made a cash payment of $5,000 to each of the children. What is the amount of the estate's distributions deduction?

A. $16,000
B. $10,000
C. $8,000
D. $6,000

65. The due date for filing a federal estate tax return, Form 706, is:

A. 30 days after the decedent's death
B. 60 days after the decedent's death
C. 90 days after the decedent's death
D. 9 months after the decedent's death

66. For 1987, an estate tax return (Form 706) is required to be filed if the gross estate is more than:

A. $400,000
B. $500,000
C. $600,000
D. $700,000

67. All of the following credits are deducted from the gross estate tax to determine the net estate tax payable except:

A. Credit for foreign death taxes
B. Credit for tax on prior transfers
C. Credit for gift taxes
D. Credit for the marital deduction

68. Mr. Jones made a transfer by gift on January 2, 1987, in an amount sufficient to require the filing of a federal gift tax return, Form 709. Unless he requests an extension of time to file, Mr. Jones must file Form 709 by:

A. March 15, 1987
B. April 15, 1987
C. March 15, 1988
D. April 15, 1988

69. All of the following statements relating to the gift tax computation are true except:

A. Taxable gifts are your total gifts reduced by the annual exclusion, the charitable deduction, and the marital deduction
B. Generally, the first $10,000 of gifts made to any one person during the calendar year is excluded
C. The charitable deduction includes contributions to qualifying organizations described in section 501(c)(3) of the Code
D. You may deduct from the total amount of the gifts you made during the calendar year the value of gifts you made to your spouse limited to $20,000

70. Which of the following is not a factor to be considered in determining whether gross income is effectively connected with the conduct of a trade or business within the U.S. by a foreign corporation?

A. The income is from assets used in the conduct of that trade or business
B. The income is from assets held for use in conduct of that trade of business
C. The activities of that trade or business were a material factor in the realization of the income
D. The majority of the stock is held in the United States

71. Which of the following statements regarding taxable dividends paid to a foreign corporation is true?

A. No withholding is required
B. Withholding is required only if the corporation resides in a country that has entered into a treaty with the United States
C. Withholding is generally required
D. Withholding is required only if the corporation resides in a country that has not entered into a treaty with the United States

Turn to the next page for Part III, Section C

Part III

Section C

Questions 72 - 90

The following questions may require some computation. Select the most appropriate answer and darken completely the circle under the corresponding letter on the answer sheet.

72. Corporation D, which had a tax liability due of $200, filed its income tax return 4 months after the due date. D did not request an extension of time for filing and did not show reasonable cause for filing late. What is the amount of the failure to file penalty?

A. $40
B. $50
C. $100
D. $200

73. What would be the alternative minimum tax for a corporation whose tax return reflects the following?

Alternative minimum taxable income	$107,500
Foreign tax credits	1,375
Regular tax	6,890

A. $5,235
B. $12,125
C. $13,235
D. $13,500

74. Mr. Green transferred land with a fair market value of $25,000 and an adjusted basis to him of $10,000 to Corporation X in exchange for 100% of X's only class of stock and an automobile owned by X with an adjusted basis to X of $13,000. At the time of the transfer, the stock had a fair market value of $29,000 and the automobile had a fair market value of $11,000. What is the amount of gain to be recognized by Mr. Green due to the transfer:

A. $30,000
B. $19,000
C. $13,000
D. $11,000

75. Mr. Jones transferred $35,000 cash and land with a fair market value of $60,000 and an adjusted basis to him of $50,000 to Corporation Z for 100% of Z's only class of stock. The stock had a fair market value of $95,000 at the time of the transfer. What is the amount of Corporation Z's basis in the land?

A. $50,000
B. $60,000
C. $85,000
D. $95,000

76. During 1987, Mr. Smith transferred land with a fair market value of $15,000 and an adjusted basis to him of $12,000 to Corporation Y in exchange for 40% of Y's only class of stock. The stock had a fair market value of $18,000 at the time of the exchange. What is the amount of Corporation Y's basis in the land?

A. $-0-
B. $12,000
C. $15,000
D. $18,000

77. During 1987, Mrs. B transferred land and buildings to Corporation P for 100% of P's only class of stock plus $150,000 in cash. On the date of the transfer, the land and buildings had an adjusted basis to Mrs. B of $300,000 and a fair market value of $350,000. What is the amount of Mrs. B's basis in Corporation P's stock?

A. $150,000
B. $300,000
C. $450,000
D. $500,000

78. Corporation J, a calendar year corporation, started business on January 3, 1987, and paid $15,000 for several items that qualify as organizational costs. If the corporation elects to amortize these costs, what is the maximum amortization deduction allowable on J's 1987 income tax return?

A. $1,500
B. $3,000
C. $7,500
D. $15,000

79. For 1987, Corporation Y had a $15,000 loss from operations and $95,000 in dividends received from taxable domestic corporations. Y's taxable income is $80,000 before the deduction for dividends received is considered. What is the amount of Y's dividend received deduction?

A. $-0-
B. $64,000
C. $76,000
D. $80,000

80. During 1987, Ink Corporation made charitable contributions of cash totaling $7,000. Ink Corporation had taxable income of $50,000 after the dividends received deduction. Dividends received from taxable domestic corporations during the year totaled $10,000. What is Ink Corporation's charitable contribution deduction for 1987?

A. $7,000
B. $5,800
C. $5,750
D. $5,000

81. For 1987, a corporation had taxable income of $50,000 without regard to the contribution deduction. Contributions made in 1987 totaled $4,000. A $3,000 carryover of excess contributions from 1986 is available to apply to 1987. What is the amount of contribution carryover available for 1988 and what is its source?

A. -0-
B. $2,000 from 1987
C. $2,000 from 1986
D. $3,000 from 1986

82. For 1987, Corporation Z, a calendar-year corporation had $300,000 gross income from business operations and $350,000 of allowable business expenses. Z also received $60,000 in dividends from other domestic taxable corporations. What is the amount of Corporation Z's net operating loss?

A. $-0-
B. $38,000
C. $41,000
D. $50,000

83. How much of Corporation A's 1986 net operating loss of $100,000 may be deducted in 1987 based on the following information pertaining to A's 1987 return?

Taxable income before the net operating loss deduction	$81,000
Charitable contribution deduction	$ 9,000
Total charitable contributions for 1987	$12,000

A. $69,000
B. $81,000
C. $90,000
D. $93,000

84. On January 1, 1987, Corporation B bought 10,000 shares of common stock of Corporation P, a taxable domestic corporation, for $10,000. On June 1, 1987, at which time the fair market value of the stock of corporation P was $12,000, P paid a $1,200 dividend on those shares of stock. On April 1, 1988 B sold the stock. What was the amount of B's basis in the stock sold?

A. $8,800
B. $9,040
C. $10,000
D. $11,200

85. J, a calendar year corporation, which began business in 1958, had accumulated earnings and profits on January 1, 1987, of $40,000. J had an operating loss of $32,000 for the first 6 months of 1987, but had earnings and profits of $5,000 for the entire year. A distribution of $12,000 was made to the stockholders on July 1, 1987. What is the proper tax treatment of the distribution to the individual stockholders?

A. No taxable transaction
B. $5,000 ordinary dividend
C. $8,000 ordinary dividend and $4,000 return of capital
D. $12,000 ordinary dividend

86. Corporation A owns 100 shares of Corporation B stock. The stock cost A $5 per share, but currently has a fair market value of $8 per share. If the stock is distributed to a shareholder, what is the amount of Corporation A's recognized gain?

A. $0
B. $300
C. $500
D. $800

87. On January 1, 1987, Corporation B, a calendar year corporation that began business in 1980, had accumulated earnings and profits of $50,000. On July 1, 1987, B distributed $20,000 to its shareholders. B had a deficit in earnings and profits of $60,000 for 1987. What is the amount of B's earnings and profits as of December 31, 1987?

A. $-0-
B. $(10,000)
C. $(20,000)
D. $(30,000)

88. Corporation D, a calendar year S corporation, was formed January 1, 1986. Mr. Jones owns 50% of D's stock which had a basis to him of $125,000 on January 1, 1986. On February 1, 1986, Corporation D borrowed $20,000 from its bank and $25,000 from Mr. Jones for use in its business. D had losses from operations of $120,000 in 1986 and $210,000 in 1987. D has not repaid any of the loan from Mr. Jones. What amount of Mr. Jones' share of D's 1987 loss is deductible on his 1987 individual return?

A. $90,000
B. $100,000
C. $105,000
D. $210,000

89. Corporation A, an S corporation, is liable for the capital gains tax for 1987. For 1987, Corporation A had net long-term capital gains of $70,000 and a net short-term capital loss of $25,000. Had Corporation A been a regular corporation, the tax due on its taxable income would have been $1,000. The applicable capital gains tax rate is 34%. What is the amount of Corporation A's capital gains tax for 1987?

A. $340
B. $1,000
C. $15,300
D. $23,800

90. During 1987, Mr. & Mrs. X made joint gifts to their son of the following items:

A painting with an adjusted basis of $15,000 and fair market value of $45,000.
Stock with an adjusted basis of $27,000 and a fair market value of $30,000
An auto with an adjusted basis of $15,000 and a fair market value of $17,000.
An interest free loan of 8,000 for a boat (for the son's personal use) on January 1, 1987, which was repaid by their son on December 31, 1987. The applicable federal rate was 11% per annum.

What is the gross amount of gifts includible in Mr. & Mrs. X's gift tax return?

A. $92,880
B. $92,000
C. $57,880
D. $57,000

END OF PART III

Special Enrollment Examination

Part IV

Ethics, Recordkeeping Procedures, Appeals. Procedures. Retirement Plans. Practitioner Penalty Provisions, and Research Materials

Instructions:

The time allotted for this part of the examination is 1 hour 30 minutes. No additional time will be granted.

On your answer sheet in the spaces provided you should enter the following:

1. Sign your name (First, M.I., Last).
2. IRS Regional office number.
3. IRS District office number.
4. Date of this examination.
5. Print your name (Last, F.I., M.I.) in the boxes provided. Immediately below the boxes darken the circle corresponding to each letter you have printed, as in the Sample Name Grid. Darken only one circle in each column below a box in which you have printed a letter. Make no marks in the columns below boxes you have left blank.
6. Enter your candidate number and immediately below, darken the circle corresponding to each number you have entered.

Important:

The answer sheet should not be folded, spindled, stapled, punctured or paper clipped since it will be machine graded.

Read the examination questions carefully. All references are to the Internal Revenue Code as amended through December 31, 1987. Unless otherwise stated all questions relate to the calendar year 1987.

You will be given a No. 2 pencil by the monitor. Darken completely only one circle under the corresponding letter on the answer sheet. In making corrections, erase errors completely. You will be allowed to keep your examination questions books after completion of the examination. Scratch paper will be provided, but you may make necessary computations in the question books. Raise your hand to attract the monitor's attention when you need extra supplies or for permission to leave the room.

When you finish the examination, your answer sheet must be turned in to the monitor before leaving the room. The examination will be graded in Washington, D.C., by the Office of Director of Practice, Internal Revenue Service. You will receive formal notification of your examination results on or about December 31, 1988.

General Grading Information:

The questions in this examination have been assigned a value of 1 or 2 points. All true or false questions have a value of 1 point each; the multiple choice questions in Section B have a value of 2 points each.

The examination is graded on the basis of correct answers. If more than one circle is darkened in answering a question, the answer will be considered incorrect.

The Service will include the answers with your formal notification of examination results. Several commercial tax services also publish the examination with their suggested answers. Therefore, you may want to mark your answers in your examination question book and retain it for purposes of your own future comparison.

Part IV

Section A

Questions 1 - 55

The following statements are either true or false. Indicate your selection on the answer sheet by darkening the circle under A for true or under B for false.

1. Mr. D who is not recognized to practice before the Internal Revenue Service, is employed by Ms. F, an enrolled agent. One of Ms. F's clients has been notified that her 1986 tax return has been selected for audit by the Service. F had prepared the return and signed it as the preparer. Mr. D can represent the client as her advocate at the audit provided he has F's written authority to do so and has the client's power of attorney.

2. An individual whose application for enrollment has been denied by the Director of Practice has 30 days after receipt of the notice of denial in which to file a written appeal to the Secretary of the Treasury.

3. An individual who is not an attorney, CPA, or enrolled agent, who is a regular fulltime employee of Corporation X, may represent X before the Internal Revenue Service provided that individual presents satisfactory identification.

4. A practitioner who is not an attorney, CPA, or enrolled agent, who signs a return as having prepared it for the taxpayer may, with proper authorization from the taxpayer, appear as the taxpayer's representative before revenue officers of the Collection Division of the Internal Revenue Service with respect to the taxpayer's tax liability for the period covered by that return.

5. Trusts, receiverships, guardianships, or estates may be represented by their trustees, receivers, guardians, administrators or executors even if they are not enrolled agents, attorneys or CPAs.

6. A practitioner who is not an attorney, CPA, or enrolled agent, who signs a return as having prepared it for the taxpayer may, with proper authorization from the taxpayer, appear as the taxpayer's advocate with or without the taxpayer before revenue agents and examining officers of the Examination Division of the Internal Revenue Service with respect to the taxpayer's tax liability for the period covered by that return.

7. Enrolled agents are required to promptly submit records or information upon a proper and lawful request by a revenue agent in connection with an examination of a taxpayer, unless the enrolled agent believes in good faith and on reasonable grounds that such record or information is privileged or that the request is doubtfully legal.

8. Mr. C was an enrolled agent until June, 1987, when he was suspended from practice before the Internal Revenue Service. Prior to his suspension, C had been representing Mr. X who was under investigation by the Internal Revenue Service for possible tax fraud. Because of C's suspension, which was not related to his work on X's case, X retained P, an enrolled agent, to represent him. P may employ C as a consultant to assist him on X's case.

9. An individual who has filed a proper application for enrollment to practice before the Internal Revenue Service and has been granted temporary recognition to practice cannot publicly advertise that he or she is "enrolled to practice before the Internal Revenue Service."

10. On December 15, 1987, Ms. J, an enrolled agent, placed an ad in a local publication that she would prepare a complex Form 1040 for $150. On February 1, 1988, the owner of J's office building unexpectedly increased her rent by a large amount. Ms. J determined she would have to charge $175 to make a profit. J is bound to the $150 fee until February 15, 1988.

11. Mr. R, an enrolled agent, wanted to have Mr. W as a new client. Without invitation, R approached W at the local social club and explained how he could assist W with his federal tax matters and would like to have him as a client. R is in violation of the solicitation regulations set forth in Treasury Department Circular No. 230.

12. An enrolled agent may be disbarred or suspended from practice before the Internal Revenue Service for maintaining a partnership for the practice of tax law and accounting with a person who is under disbarment from practice before the Internal Revenue Service.

13. An Administrative Law Judge presides at the hearing on a complaint for the disbarment or suspension of an enrolled agent, attorney or CPA. The enrolled agent, attorney, or CPA may appear at this hearing in person or be represented by another as long as that person is an enrolled agent, attorney, or CPA.

14. If a taxpayer is filing a claim for refund, based solely on contested income tax issues considered in previously examined returns, and does not want to appeal to the Internal Revenue Service, the taxpayer should request in writing that the claim be immediately rejected so that the taxpayer can file a refund suit in the U.S. District Court having jurisdiction or the U.S. Claims Court.

15. Mr. G's 1986 income tax return was examined by the Internal Revenue Service at G's office. The examining officer made the determination that G owed additional tax of $2,200. Mr. G does not agree with these findings and wishes to schedule a conference with an IRS Appeals Office. G must file a written protest of these findings in order to obtain the conference.

16. Mr. K's income tax return was audited by the Internal Revenue Service. The Service determined that K's income tax liability was greater than that shown on his return. If K disagrees, he must participate in a conference with an IRS Appeals Office before he can appeal to the courts.

17. A was audited for 1986 and agreed to the findings of the Internal Revenue Service examiner that she owed an additional $500. A will be charged interest on the additional tax from the due date of the return to the billing date if she does not pay the tax when she signs the agreement form. However, A will not be billed for more than 30 days interest from the date she signs the agreement.

18. The "small tax case procedures" may be requested by taxpayers with disputes before the Tax Court only if the case involves a dispute of not more than $5,000 tax for any one tax year or period.

19. Ms. W, a supervisory employee of an accounting firm, is responsible for the overall substantive accuracy of all income tax returns prepared by subordinates for the firm's clients. Ms. W neither gathers the necessary information nor prepares the income tax forms. Ms. W is considered to be the preparer and should manually sign the returns as the preparer.

20. The $100 preparer penalty for negligent or intentional disregard of rules and regulations cannot be asserted unless there is an understatement of tax liability.

21. An income tax return preparer who fails to furnish a copy of the return or claim for refund to the taxpayer shall be subject to a $25 penalty for the failure unless it is shown that the failure is due to reasonable cause and not due to willful neglect.

22. The requirement that a preparer manually sign a return after it is completed and before it is presented to the taxpayer, may be satisfied by a photocopy of the copy of the return which the preparer manually signed. However, the preparer is required to retain the manually signed copy of the return.

23. An enrolled agent will not meet the requirement of the regulations relating to tax return preparers for furnishing the preparers identifying number on tax returns they are required to sign by entering his or her enrolled agents identifying number.

24. A return preparer who retains a list identifying by name, taxpayer identification number, taxable year and type of return prepared does not have to retain a completed copy of the return prepared.

25. Each person who employs one or more tax return preparers must keep a record of the name, taxpayer identification number, and principal place of work during the return period for each preparer employed by the person at any time during that period. This record must be retained and kept available for inspection by the Internal Revenue Service for the 3-year period following the close of the return period for which that record relates.

26. An income tax return preparer, other than a preparer-bank, that collects return preparation fees by endorsing and cashing income tax refund checks for clients and withholding the amount of the fee will be subject to a $500 penalty for each check negotiated in this manner.

27. If a joint return is involved and the husband and wife are to be represented by the same representative, the power of attorney requires only one signature, the husband or the wife.

28. A taxpayer's representative is required to submit to the Internal Revenue Service a power of attorney properly executed by the taxpayer if the representative wishes to extend the statutory period for assessment or collection of a tax on behalf of the taxpayer.

29. A taxpayer may execute a tax information authorization allowing the taxpayer's representative to receive or inspect confidential tax information only if the representative qualifies for practice before the Internal Revenue Service under the regulations in Treasury Department Circular No. 230.

30. A tax information authorization is not required of a taxpayer's representative at a conference with IRS officials which is also attended by the taxpayer.

31. An enrolled agent must file a written declaration that he is currently qualified as an enrolled agent and is authorized to represent the particular party on whose behalf he is acting when appearing for the initial meeting in the first office of the Internal Revenue Service in which he represents the party.

32. Form 2848, Power of Attorney and Declaration of Representative, properly executed by the taxpayer, permits the taxpayer's representative to make substitution of representatives or delegate authority to other representatives without the taxpayer's specific grant of authority to do so.

33. In the event that a power of attorney is filed specifically authorizing more than one representative to receive checks in payment of refund of Internal Revenue taxes on the taxpayer's behalf, and such representatives have different addresses, the Internal Revenue Service will automatically mail the check to the representative first appearing on the power of attorney.

34. A power of attorney or a tax information authorization is not required by the Internal Revenue Service in cases docketed in the Tax Court.

35. Federal law does not require a taxpayer to maintain any special form of records but the records must be such that the taxpayer can prepare a complete and accurate income tax return.

36. A taxpayer should keep records that support the items on the taxpayer's return until the statute of limitations for the return expires. Usually this is 3 years from the date the return was due or filed or 2 years from the date the tax was paid, whichever date is later.

37. You must keep your records on employment taxes, (income tax withholding, social security, and federal unemployment tax) for at least 4 years after the due date of the return or after the date the tax is paid whichever is later.

38. A Keogh plan may only be established by an employer for the benefit of employees or their beneficiaries. For this purpose, a self-employed person with net earnings from self-employment is both an employer and an employee.

39. A partnership may not set up a Keogh plan.

40. A pension plan will satisfy the minimum coverage requirement of the Internal Revenue Code if the plan benefits 70% or more of all employees.

41. The exclusion from a pension plan of employees whose entire pay is subject to social security tax will not be considered discriminatory merely because of this exclusion.

42. For Keogh plan purposes, common-law employees are not self-employed with respect to income from their work even if that income is self-employment income for social security tax purposes.

43. For tax years beginning after 1986, an employee is not longer allowed to make deductible contributions to a Keogh plan.

44. A 10% premature distribution tax will not be imposed on a Keogh plan distribution to an owner who has not reached age 59 1/2 if the distribution is made on account of disability.

45. For years beginning after 1986, if your contributions to a Keogh plan are less than the deductible limit, you can carry the unused amount over to a later year.

46. For 1987, Ms. G, a single taxpayer, had modified adjusted gross income of $25,500 consisting of $24,500 in salary from a local construction company and $500 in interest from her bank. G is covered by an employee retirement plan. For 1987, Ms. G can deduct up to $2,000 as a contribution to an IRA.

47. If a taxpayer has made deductible and nondeductible contributions to an IRA, the amount of a distribution that can be excluded from income is computed as follows:

Amount of distribution X Nondeductible contributions

48. During 1987, Mr. J, who is single, earned $22,000 from his employment at a local factory and contributed $3,000 to his IRA. J can avoid the penalty excise tax on his excess contribution if he withdraws it by the due date of his return including extensions.

49. Beginning in 1987, an employer's contribution to a simplified employee pension (SEP)-IRA, should not be included in the employees Form W-2, Wage and Tax Statement, and the employee should not include the contribution in his income or deduct it on his return.

50. An organization that is exempt from federal income tax that has $1,000 or more in gross income from an unrelated business, must file Form 990-T, Exempt Organizations Business Income Tax Return.

51. The United States Tax Court is the only court bound by the Internal Revenue Code except where the Code is held to violate the constitution.

52. The courts are bound by legislative regulations but not by interpretative regulations.

53. Both the taxpayer and the Government may appeal "small tax case procedure" decisions of the Tax Court to the Court of Appeals.

54. A taxpayer may pay a disputed deficiency and then file a claim for a credit or refund. If the Service has not acted on the claim within 6 months from the date the claim was filed, the taxpayer may file a suit for a credit or refund with either the United States Claims Court or United States District Court.

55. The Commissioner of Internal Revenue will announce acquiescence or nonacquiescence only when the Tax Court's decision is adverse to the Service's position.

Turn to the next page for Part IV, Section B

Part IV

Section B

Questions 56 - 75

The following questions are multiple choice. Select the most appropriate answer and darken the circle under the corresponding letter on the answer sheet.

56. All of the following statements regarding proceedings for disbarment or suspension of an attorney, certified public accountant, or enrolled agent from practice before the Internal Revenue Service are true except:

- **A.** A complaint shall contain a clear and concise description of the allegations which constitute the basis for the proceedings
- **B.** Failure to answer the complaint as required will render a decision by default against the respondent
- **C.** Every allegation in the complaint which is not denied will be deemed to be admitted by the respondent and may be considered as proved
- **D.** The respondent to the complaint must file his answer with the Director of Practice within 15 days from the date the complaint is served

57. A proceeding for disbarment or suspension from practice before the Internal Revenue Service against an attorney, certified public accountant or enrolled agent may be instituted by which of the following?

- **A.** The District Director of Internal Revenue where the alleged misconduct occured
- **B.** The Director of Practice
- **C.** An Administrative Law Judge
- **D.** All of the above

58. B filed her 1984 Form 1040 on April 15, 1985, but did not pay her tax liability of $3,000. On June 15, 1986, she paid the tax in full. In 1987, B discovered additional deductions for 1984 that will result in a refund of $1,000. To receive her refund, B must file an amended income tax return by:

- **A.** June 15, 1988
- **B.** April 15, 1988
- **C.** June 15, 1989
- **D.** April 15, 1989

59. B wishes to appeal the findings of the United States Claims Court concerning his tax liability. B must appeal to:

- **A.** United States Court of Appeals for the Federal Circuit
- **B.** United States Distric Court
- **C.** United States Board of Tax Appeals
- **D.** United States Court of Appeals for B's circuit

60. All of the following statements relating to the notice of deficiency are true except:

- **A.** If a taxpayer pays the tax after the notice of deficiency has been issued, the taxpayer can no longer petition the Tax Court for review
- **B.** The notice provides the taxpayer 90 days (150 days if the taxpayer lives outside the United States) to either agree to the deficiency or file a petition with the United States Tax Court for a redetermination of the deficiency
- **C.** The notice is not an assessment of tax
- **D.** The Service may with the taxpayer's consent rescind a notice of deficiency issued after 1985 and once rescinded it is treated as if it never existed

61. A return preparer who is subject to a proposed return preparer negligence penalty under Code Section 6694, may appeal the proposed penalty if the preparer believes that the understatement of tax liability was not due to negligence. Which of the following appeal procedures is not available?

A. Request a conference with the IRS appeals office by timely responding to a 30-day letter
B. Pay at least 15% of the assessed penalty and file a claim for refund. If the claim is denied by the Service, bring suit in the appropriate United States district court within 30 days after the day of denial
C. Do not pay the penalty and petition the Tax Court within 90 days after receiving the final notice
D. Request a meeting with the group manager of the IRS agent who has proposed the penalty

62. Which of the following is included in the specific records that are required to be maintained for income tax withholding?

A. If the taxable amount is less than the total payment, the reason why it is less
B. For accident or health plans, information about each payment
C. The dates in each calendar quarter on which any employee worked for the employer, not in the course of the employer's trade or business, and the amount paid for that work
D. All of the above

63. The annual additions by a defined contribution plan, that's not a profit sharing plan, to the account of a participant may not exceed:

A. The smaller of $30,000 or 25% of the participant's compensation
B. The larger of $30,000 or 25% of the participant's compensation
C. The smaller of $30,000 or 15% of the participant's compensation
D. The larger of $30,000 or 15% of the participant's compensation

64. Prohibited transactions between a qualified retirement plan and disqualified persons include all of the following transactions except:

A. Benefit received which the disqualified person is entitled to as a plan participant if it is figured and paid under the same terms as for all other participants and beneficiaries
B. A fiduciary's receiving consideration for his or her account from a party that is dealing with the plan in a transaction that involves plan income or assets
C. Extending credit, such as a loan
D. Selling, exchanging or leasing property

65. Unless an extension of time to file is granted, Form 5500, Annual Return/Report of Employee Benefit Plan for plans with 100 or more participants must be filed by:

A. The 15th day of the 3rd month following the end of the plan year
B. The 15th day of the 4th month following the end of the plan year
C. The last day of the 7th month following the end of the plan year
D. The last day of the 9th month following the end of the plan year

66. All of the following arrangements are acceptable ways to establish an IRA for 1987 except:

A. A salary reduction arrangement
B. Endowment contracts used as retirement annuities
C. Employer and employee association trust accounts
D. A simplified employer pension

67. All of the following would be prohibited transactions with an IRA except:

A. Borrowing money from it
B. Selling property to it
C. Receiving reasonable compensation for managing it
D. Using it as security for a loan

68. All of the following would be considered earned compensation for purposes of an IRA except:

A. Rental income
B. Partnership income if an active partner
C. Commissions based on a percentage of sales
D. Wages

69. An excise tax on the excess accumulations of an individual IRA are taxed at what percentage if you have not begun receiving distributions by April 1, of the year following the year in which you reach age 70 1/2.

A. 20%
B. 30%
C. 40%
D. 50%

70. Any organization, other than a private foundation, seeking to obtain recognition of exemption from Federal income tax, must file Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, unless they meet the gross income test. An organization will meet this test in all of the following instances except:

A. If, during its first tax year its gross receipts totaled $7,500 or less
B. If, during its first 2 years its gross receipts totaled $12,000 or less
C. If it had been in existence at least 3 years, and its gross receipts for the immediately preceding 2 years, plus the current year totaled $15,000 or less
D. If, during its first 2 years its gross receipts totaled $15,000 or less

71. All of the following types of legal entities meet the organizational test for acquiring exempt status under Code Section 501(c)(3) except:

A. Corporations
B. Partnerships
C. Trusts
D. Foundations

72. All of the following statements relating to Treasury Regulations are true except:

A. All regulations are written by the Legislation and Regulations Division of the Office of Chief Counsel, IRS, and approved by the Secretary of the Treasury
B. Proposed regulations automatically replace temporary regulations
C. Some Code sections specifically authorize regulations to provide the details of the meaning and rules for that particular section. These are called legislative regulations
D. Regulations are not binding on any court

73. All of the following statements are true except:

A. The purpose of revenue rulings is to promote a uniform application of the tax laws, and therefore IRS employees must follow the rulings
B. Revenue rulings are published conclusions of the IRS concerning the application of tax law to an entire set of facts
C. Revenue procedures are official statements of procedures that either affect the rights or duties of taxpayers or other members of the public, or should be a matter of public knowledge
D. Taxpayers cannot appeal adverse return examination decisions based on revenue rulings to the Tax Court

74. Ms. B does not agree with a proposed deficiency of additional tax resulting from an examination of her 1985 individual income tax return. She has not been able to satisfactorily resolve her case within the administrative processes of the Internal Revenue Service. Which of the following courts may she petition without first making payment of the contested deficiency?

A. United States Tax Court
B. United States Claims Court
C. United States District Court
D. None of the above

75. All of the following statements are true except:

A. If the Commissioner of Internal Revenue has filed nonacquiescence to a decision of the Tax Court he cannot revise it and must appeal to a higher court
B. Decisions of the courts other than the Supreme Court do not require the Internal Revenue Service to alter its position for all other taxpayers
C. A petition to the Supreme Court to have a case that it is not obliged to review is by writ of certiorari which is initially requested by the appealing party
D. The writ of certiorari is issued by the Supreme Court to the lower appellate court requesting the record of a case for review

END OF PART IV

INTERNAL REVENUE SERVICE

SPECIAL ENROLLMENT EXAMINATION ANSWER SHEET

SIGNATURE: _____
(Please Sign)

PLACE OF EXAMINATION: REGION NO. _____ **DISTRICT NO.** _____

TODAY'S DATE: _____

DO NOT FOLD, SPINDLE, STAPLE, PUNCTURE OR PAPER CLIP THIS FORM

DIRECTIONS FOR MARKING ANSWER SHEET

SAMPLE (A) (●) (C) (D) (E)

Use only a **No. 2 (or softer) lead pencil.** Darken completely the circle corresponding to your answer. You **must** keep your mark within the circle. Stray marks may be counted as errors. Erase **completely** all marks except your answer.

1. In the boxes below, **PRINT** your name. Print only as many letters as will fit within the areas for the last name, first initial (F.I.), and middle initial (M.I.). Below each box, darken the circle containing the same letter. SEE SAMPLE NAME GRID.

LAST NAME | F.I. | M.I.

SAMPLE NAME GRID

LAST NAME															F.I.	M.I.
M	C	C	A	B	E										C	A

2. CANDIDATE NUMBER

Make no marks or entries in the columns to the right until you receive instructions from the administrator.

PART I

Spine Code 123

Form 1736 Part I Rev. 7-86)

PART II

Spine Code 124

Make no marks or entries in the columns to the right until you receive instructions from the administrator

1 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	11 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	31 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	51 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	71 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	90 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
2 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	12 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	32 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	52 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	72 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	91 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
3 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	13 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	33 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	53 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	73 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	92 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
4 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	14 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	34 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	54 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	74 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	93 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
5 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	15 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	35 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	55 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	75 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	94 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
6 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	16 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	36 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	56 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	76 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	95 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
7 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	17 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	37 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	57 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	77 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	96 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
8 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	18 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	38 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	58 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	78 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	97 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
9 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	19 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	39 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	59 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	79 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	98 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
10 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	20 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	40 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	60 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	80 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	99 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
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PART III

Spine Code 125

Make no marks or entries in the columns to the right until you receive instructions from the administrator

1 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	11 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	31 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	51 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	71 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	90 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
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5 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	15 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	35 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	55 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	75 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	94 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
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	29 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	49 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	69 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	89 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	
	30 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	50 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	70 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ		

PART IV

Spine Code 126

Make no marks or entries in the columns to the right until you receive instructions from the administrator

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3 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	13 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	33 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	53 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	73 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	92 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
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6 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	16 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	36 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	56 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	76 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	95 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
7 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	17 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	37 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	57 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	77 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	96 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ
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	27 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	47 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	67 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	87 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	
	28 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	48 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	68 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	88 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	
	29 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	49 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	69 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	89 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	
	30 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	50 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ	70 Ⓐ Ⓑ Ⓒ Ⓓ Ⓔ		

1988 Special Enrollment Exam Answers

PART I				PART II				PART III				PART IV			
Q.	A.	Q.	A.	Q.	A.	Q.	A.	Q.	A.	Q.	A.	Q.	A.	Q.	A.
1	T	59	B	1	F	59	A	1	T	59	D	1	F	59	A
2	F	60	*	2	T	60	B	2	T	60	C	2	T	60	A
3	T	61	D	3	F	61	C	3	T	61	C	3	T	61	C
4	F	62	B	4	T	62	A	4	T	62	B	4	F	62	D
5	F	63	A	5	F	63	B	5	F	63	B	5	T	63	A
6	T	64	B	6	T	64	A	6	F	64	B	6	T	64	A
7	F	65	B	7	F	65	C	7	F	65	D	7	T	65	C
8	F	66	B	8	F	66	*	8	T	66	C	8	F	66	B
9	F	67	A	9	F	67	C	9	F	67	D	9	T	67	C
10	F	68	D	10	T	68	B	10	T	68	D	10	F	68	A
11	F	69	A.	11	T	69	C	11	T	69	D	11	T	69	D
12	T	70	B	12	F	70	D	12	T	70	D	12	T	70	D
13	F	71	B	13	F	71	B	13	F	71	C	13	F	71	B
14	F	72	A	14	F	72	B	14	T	72	C	14	T	72	B
15	F	73	B	15	F	73	B	15	F	73	A	15	F	73	D
16	T	74	B	16	T	74	B	16	T	74	D	16	F	74	A
17	T	75	D	17	T	75	A	17	F	75	A	17	T	75	A
18	T	76	C	18	T	76	A	18	T	76	D	18	F		
19	F	77	B	19	T	77	A	19	T	77	*	19	T		
20	F	78	C	20	T	78	D	20	F	78	B	20	T		
21	T	79	A	21	T	79	C	21	F	79	B	21	T		
22	T	80	D	22	T	80	C	22	T	80	B	22	T		
23	T	81	A	23	T	81	B	23	T	81	C	23	T		
24	T	82	D	24	T	82	A	24	F	82	B	24	T		
25	T	83	A	25	T	83	B	25	F	83	B	25	T		
26	F	84	B	26	F	84	B	26	T	84	B	26	T		
27	F	85	D	27	T	85	B	27	T	85	D	27	F		
28	F	86	B	28	F	86	B	28	T	86	B	28	T		
29	T	87	B	29	F	87	B	29	F	87	D	29	F		
30	T	88	B	30	D	88	B	30	T	88	A	30	T		
31	D	89	D	31	A	89	A	31	F	89	B	31	T		
32	C	90	C	32	D	90	C	32	T	90	B	32	T		
33	C			33	D			33	T			33	F		
34	B			34	C			34	T			34	T		
35	D			35	B			35	T			35	T		
36	C			36	D			36	T			36	T		
37	B			37	D			37	T			37	T		
38	C			38	B			38	T			38	T		
39	A			39	D			39	T			39	F		
40	C			40	C			40	T			40	T		
41	B			41	C			41	T			41	T		
42	B			42	A			42	C			42	T		
43	B			43	D			43	A			43	T		
44	D			44	C			44	B			44	T		
45	B			45	B			45	C			45	F		
46	B			46	C			46	B			46	T		
47	B			47	B			47	B			47	F		
48	C			48	D			48	D			48	T		
49	A			49	A			49	B			49	T		
50	D			50	B			50	D			50	T		
51	A			51	B			51	A			51	F		
52	C			52	D			52	C			52	F		
53	B			53	B			53	D			53	F		
54	C			54	C			54	B			54	T		
55	B			55	B			55	C			55	T		
56	A			56	A			56	B			56	D		
57	C			57	B			57	C			57	B		
58	A			58	B			58	D			58	A		

*All examinees were given credit.

Special Enrollment Examination

Study Material Request and Mailing Label

best copy available

Special Enrollment Examination *(SEE)*
Study Material Request and Mailing Label

For expeditious shipment of the Special Enrollment Examination Study Material, please complete the lower portion of this page and mail it to the address listed below. Please print "SEE" in the lower left front corner of your envelope. (Please **do not** send this form with your application Form 2587)

Send to: IRS Eastern Area Distribution Center
P.O. Box 25866
Richmond, VA 23260

Please expedite shipment of one packet of IRS Special Enrollment Study Material to the name and address shown below.

Contents of the SEE Study Materials Packets:

Pub. 15
Pub. 17
Pub. 216
Pub. 334
Pub. 349
Pub. 448
Pub. 463
Pub. 502
Pub. 505
Pub. 515
Pub. 519
Pub. 531
Pub. 534
Pub. 536
Pub. 541
Pub. 542
Pub. 544
Pub. 551
Pub. 553
Pub. 556
Pub. 557
Pub. 559
Pub. 560
Pub. 572
Pub. 589
Pub. 590
Pub. 909
Pub. 917
Treasury Dept. Circular No. 230

Return label – Fill in your name and address below.

Internal Revenue Service
SEE Study Material Pamphlet

Name _____

Street _____

City _____ State _____ Zip _____

Form **4190A** (Rev. 3-89) Department of the Treasury – Internal Revenue Service

Special Enrollment
Examination

Application & Instructions

Instructions for Form 2587

Application for Special Enrollment Examination

(Revised April 1989)

General Information

The 1989 Special Enrollment Examination will be held on Thursday and Friday, September 28 and 29, 1989 as follows:

Part	*Date*	*Time*
Part I	September 28, 1989	9:00 a.m.
Part II	September 28, 1989	1:30 p.m.
Part III	September 29, 1989	9:00 a.m.
Part IV	September 29, 1989	1:30 p.m.

The **Examination Fee** is $50 if taking all four parts of the examination or $40 if taking less than four parts. The fee is not refundable. If you cannot take the examination when scheduled because of illness, accident, or other emergency, the IRS employee named in the examination credential that you receive may authorize the allowance of your fee as a credit toward next year's examination fee.

To qualify for the credit, you must give prompt notice (before the examination, when possible) and give reasons justifying allowance of the credit. When requesting a credit, you should return your examination credential to the district to be endorsed for allowance of the credit if warranted. The district coordinator will return your credential with the endorsement so you can file it with your next application. This credit is good for only 1 year.

You will *not* receive an acknowledgement of our receipt of your application. You will receive written notification from your IRS district office as to the location of the examination and time to appear for registration. If you have not received it 20 days before the examination (September 9), notify your district office.

General Instructions

This is a two part form. Your information must be typed or printed with ballpoint. If your information is incomplete or not legible, your application will be returned to you which could cause you to miss the examination.

Do not bring any books, papers, or equipment (including calculators) to the examination room. All necessary materials will be furnished by the Internal Revenue Service.

Mailing Instructions

Do not separate the two parts of this form. Mail both copies to Internal Revenue Service, P.O. Box 85854, Dallas, TX 75285.

Your application must be postmarked by the U.S. Postal Service, or similarly evidenced if a private mailing service is used, no later than July 31.

Specific Item Instructions

Item 1 – Candidate Number. We will assign and fill in a candidate number for you.

Item 2 – Signature of Applicant. You must sign and date your application.

Item 3 – Telephone. Please provide a daytime telephone number where you can be contacted. This number may be used to obtain information about your application and to advise you of any emergency changes in the examination location.

Item 4 – Social Security Number.

Item 5 – Parts To Be Taken. You must check the appropriate box(es). You are required to take all four parts of the examination if; (a) you have never taken the examination before; (b) you took the examination before 1988 and failed any of it; or (c) you took and failed all four parts of the 1988 examination. The examination fee for taking all parts if $50.

If you were required to take all four parts of the 1988 examination and passed one, two, or three parts, you need only check the box(es) for the part(s) that you failed and are required to retake in 1989. The examination fee is in this case $40. A copy of the letter with your 1988 examination results should be enclosed with this application.

You have 2 successive years in which to pass all four parts of the examination. If you do not pass all four parts within a successive 2-year period, you must retake the examination in its entirety. For example, if you were required to take all four parts in 1988, and passed one, two or three parts, you must pass the parts that you failed in 1989. If you do not, you will have to retake the examination in its entirety in 1990.

You must take all required parts to receive credit for any parts passed. If you do not take all required parts of the examination, you do not receive credit for any parts passed.

Item 6 – Name and Address. Type or print clearly with ballpoint your name and address. Any future change of name and address should be sent to: Internal Revenue Service; Office of Director of Practice, HR:DP; 1111 Constitution Avenue, NW; Washington, DC 20224.

Item 7 – Preferred Examination Site. Enter the city and state (see item 8, Location Code) where you prefer to take the examination.

Item 8 – Location Code. The examination is offered in each city where a district headquarters office is located. However, the District may also designate other locations within the district if enough candidates request it.

The following list is in alphabetic order by state and provides you with the cities where District Offices are located (*) and other cities within the state where the examination has been given. The location code to be entered in Item 8 is listed opposite the city. You will note that some cities have the same code. That is because they are within the same IRS district. This code is necessary because the information in the application is computerized and it allows us to distribute your application to the appropriate IRS office. You may select a city in a state other than the state in which you reside.

Your Application Will Not Be Accepted Unless You:

- Sign and date it (item 2);
- Include a check or money order for your examination fee payable to Internal Revenue Service ($50 for all four parts or $40 if less than four parts);
- Enter parts to be taken (item 4);
- Your application must be postmarked by the U.S. Postal Service, or similarly evidenced if a private mailing service is used, no later than July 31, 1989.

Examination Sites	Location Codes
Alabama	
Birmingham *	163
Alaska	
Anchorage *	992
Arizona	
Phoenix *	586
Tempe	586
Arkansas	
Little Rock *	171
California	
Buena Park	933
Concord	968
Fresno	977
Irvine	933
Laguna Niguel *	933
Long Beach	933
Los Angeles *	995
Oakland	994
Redding	968
Riverside	933
Sacramento *	968
San Diego	933
San Francisco *	994
San Jose *	977
Ventura	977
Colorado	
Denver *	584
Connecticut	
Hartford *	606
Delaware	
Wilmington *	851
District of Columbia	852
Florida	
Ft. Lauderdale *	165
Jacksonville *	159
Miami	165
Orlando	159
Panama City	159
Tampa	159
Georgia	
Atlanta *	158

Examination Sites	Location Codes
Hawaii	
Honolulu *	999
Idaho	
Boise *	982
Illinois	
Chicago *	336
Springfield *	337
Indiana	
Evansville	435
Ft. Wayne	435
Indianapolis *	435
Merrillville	435
Iowa	
Des Moines *	342
Kansas	
Wichita *	548
Kentucky	
Louisville *	461
Louisiana	
New Orleans *	172
Maine	
Augusta *	601
Maryland	
Baltimore *	852
Washington, DC	852
Massachusetts	
Boston *	604
Michigan	
Detroit *	438
Lansing	438
Minnesota	
St. Paul *	341
Mississippi	
Jackson *	164
Missouri	
St. Louis *	343
Kansas City	343

Examination Sites	Location Codes
Montana	
Helena *	381
Nebraska	
Omaha *	347
Nevada	
Las Vegas *	988
Reno	988
New Hampshire	
Portsmouth *	602
New Jersey	
Newark *	822
New Mexico	
Albuquerque *	585
New York	
Albany *	614
Brooklyn *	611
Buffalo *	616
Manhattan *	613
Schenectady	614
Syracuse	616
North Carolina	
Charlotte	156
Greensboro *	156
Raleigh	156
North Dakota	
Fargo *	345
Ohio	
Canton	434
Cincinnati *	431
Cleveland *	434
Columbus	431
Toledo	434
Oklahoma	
Oklahoma City *	573
Tulsa	573
Oregon	
Portland *	993

Examination Sites	Location Codes
Pennsylvania	
Philadelphia *	823
Pittsburgh *	825
Rhode Island	
Providence *	605
South Carolina	
Columbia *	157
South Dakota	
Aberdeen *	346
Sioux Falls	346
Tennessee	
Chattanooga	162
Knoxville	162
Nashville *	162
Memphis	162
Texas	
Austin *	574
Dallas *	575
Houston *	576
Lubbock	575
Utah	
Salt Lake City *	587
Vermont	
Burlington *	603
Virginia	
Richmond *	854
Washington, DC	852
Washington	
Seattle *	991
Spokane	991
Tacoma	991
West Virginia	
Parkersburg *	455
Wisconsin	
Milwaukee *	339
Stevens Point	339
Wyoming	
Casper	583

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Washington, DC 20224

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Special Enrollment
Examination (SEE)
Application Packet